(9)

No. 00-203-CFX Title: United States, Petitioner
v.
Cleveland Indians Baseball Compan,

Docketed: August 8, 2000 Court: United States Court of Appeals for the Sixth Circuit

Entry	Date	Proceedings and Orders
	Aug 8 2000	Petition for writ of certiorari filed. (Response due September 7, 2000)
	Sep 7 2000	Brief of respondent Cleveland Indians Baseball Company in opposition filed.
	Sep 12 2000	Reply brief of petitioner United States filed.
	Sep 13 2000	DISTRIBUTED for Conference of October 6, 2000
	Oct 10 2000	REDISTRIBUTED for Conference of October 13, 2000
	Oct 16 2000	Petition GRANTED. SET FOR ARGUMENT February 27, 2001. **********
	Nov 29 2000	Joint appendix filed.
	Nov 29 2000	Brief of petitioner United States filed.
	Dec 14 2000	Order extending time to file respondent's brief on the merits to and including January 16, 2001.
	Dec 22 2000	Record filed.
	Jan 2 2001	Record filed.
	Jan 16 2001	Brief amicus curiae of Major League Baseball Players Association filed.
	Jan 16 2001	Brief of respondent Cleveland Indians Baseball Company filed.
	Jan 18 2001	CIRCULATED.
	Feb 16 2001	Reply brief of petitioner United States filed.
	Feb 23 2001	Letter and twenty copies of bound lodging received from counsel for the respondent and distributed.
	Feb 27 2001	ARGUED.

1pp

Supreme Court, U.S.
FILED

00-203 AUG 0 8 2000

OFFICE OF THE CLERK

No.

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY, A LIMITED PARTNERSHIP

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

SETH P. WAXMAN
Solicitor General
Counsel of Record

PAULA M. JUNGHANS
Acting Assistant Attorney General

LAWRENCE G. WALLACE
Deputy Solicitor General

KENT L. JONES
Assistant to the Solicitor General

KENNETH L. GREENE
ROBERT W. METZLER
Attorneys

Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

QUESTION PRESENTED

Whether, for purposes of the Federal Insurance Contributions Act, 26 U.S.C. 3101-3128, and the Federal Unemployment Tax Act, 26 U.S.C. 3301-3311, an award of back wages should be attributed to the year the award was actually paid or, instead, to the year that the events occurred that gave rise to the award.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutory provisions and regulations involved	2
Statement	2
Reasons for granting the petition	8
Conclusion	24
Appendix A	1a
Appendix B	6a
Appendix C	12a
Appendix D	14a

TABLE OF AUTHORITIES

Cases:

Atlantic Mutual Ins. Co. v. *Commissioner*, 523 U.S. 382 (1998)	14
Bowman v. *United States*, 824 F.2d 528 (6th Cir. 1987)	7, 17, 18, 19, 20, 22
Cottage Savings Ass'n v. *Commissioner*, 499 U.S. 554 (1991)	14
Flemming v. *Nestor*, 363 U.S. 603 (1960)	17
Freedomland, Inc., In re, 480 F.2d 184 (2d Cir. 1973), aff'd *sub nom. Otte* v. *United States*, 419 U.S. 43 (1974)	20, 21
Hemelt v. *United States*, 122 F.3d 204 (4th Cir. 1997)	18, 19
Johnston v. *Harris County Flood Control District*, 869 F.2d 1565 (5th Cir. 1989), cert. denied, 493 U.S. 1019 (1990)	18
Mazur v. *Commissioner*, 986 F. Supp. 752 (W.D.N.Y. 1997)	19
National Muffler Dealers Ass'n v. *United States*, 440 U.S. 472 (1979)	14

Cases—Continued: Page

San Francisco Baseball Assocs. L.P. Francisco Giants v. *United States*, 88 F. Supp.2d 1087 (N.D. Cal. 2000), cross-appeals pending, Nos. 00-15750 & 00-15890 (9th Cir.) 18, 23
Social Security Board v. *Nierotko*, 327 U.S. 358 (1946) 15, 16, 17
Walker v. *United States*, 202 F.3d 1290 (10th Cir. 2000) 19, 20

Statutes and regulations:

Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 502, 88 Stat. 829 18
Employment Security Amendments of 1970, Pub. L. No. 91-373, § 302, 84 Stat. 713 14
Internal Revenue Code (26 U.S.C.):
§ 104(a)(2) 19
§ 1401 19
§ 3101 ..... 2, 12, 14a
§ 3101(a) 3, 4, 21, 14a
§ 3101(b) 3, 4, 14a
§ 3102 5
§ 3102(a) 20
§ 3111 ..... 2, 12, 16a
§ 3111(a) 3, 4, 8, 16a
§ 3111(b) 3, 4, 8, 16a
§ 3121 ..... 2, 18a
§ 3121(a) 4, 5, 10, 12, 13, 18a
§ 3121(a) 4
§ 3121(a)(1) 4, 18a
§ 3121(v)(2) 8
§ 3301 ..... 2, 4, 5, 8, 12, 20a
§ 3301 5
§ 3301(a) 8
§ 3306 ..... 2, 12, 21a
§ 3306(b) 5, 10, 21a
§ 3402 5

Statutes and regulations: Page

§ 3402(a) 21
Social Security Act, ch. 531, 49 Stat. 620:
§ 210(a), 49 Stat. 625 15
§ 210(b), 49 Stat. 625 15
§ 801, 49 Stat. 636-637 9
§ 804, 49 Stat. 636-637 9
§ 811(a), 49 Stat. 639 10
§ 901, 49 Stat. 639 10
§ 907(b), 49 Stat. 642 10
Social Security Act Amendments of 1939, ch. 666, 53 Stat. 1360:
§ 601, 53 Stat. 1382 9
§ 604, 53 Stat. 1383 9
§ 608, 53 Stat. 1387 9-10
§ 614, 53 Stat. 1392-1393 10
Social Security Act Amendments of 1946, ch. 951, 60 Stat. 978:
§ 412(a), 60 Stat. 989 10
§ 412(b), 60 Stat. 989 10
§ 414(a)(3), 60 Stat. 991 16
Social Security Act Amendments of 1972, Pub. L. No. 92-336, § 200(b)(1), 86 Stat. 416 (§ 230, 42 U.S.C. 430) 4
Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 271(a), 96 Stat. 554 13
Unemployment Compensatoin Amendments of 1976, Pub. L. No. 94-566, § 211(a), 90 Stat. 2676 13-14
20 C.F.R. 404.1242 16
26 C.F.R.:
Section 31.3101-2(c) & Example 2, 12, 22a
Section 31.3101-3 ..... 2, 12, 22a
Section 31.3111-2 ..... 2, 22a
Section 31.3111-2(c) 2, 12, 22a
Section 31.3111-3 ..... 2, 12, 23a

Regulations—Continued: Page

Section 31.3121(a)-2 ..... 2, 23a
Section 31.3121(a)-2(a) 12-13, 19, 23a
Section 31.3121(a)(1)-1(a)(2) 2, 13, 24a
Section 31.3301-2 ..... 2, 13, 23a
Section 31.3301-3(b) 13
Section 31.3306(b)(1)-1 ..... 2, 24a
Section 31.3306(b)(1)-1(a)(1) 13, 24a
Section 31.3306(b)(1)-1(a)(2) 14, 25a
Treas. Reg. 106, § 402.228(a) (as amended by T.D. 5566, 1947-2 C.B. 148) 12
Treas. Reg. 106 (1940):
§ 402.301 12
§ 402.302 12
§ 402.303 12
§ 402.401 12
§ 402.402 12
§ 402.403 12
Treas. Reg. 107, § 403.228(a), as amended by T.D. 5566, 1947-2 C.B. 148 12

Miscellaneous:

AOD 1988-006, 1988 WL 570743 (IRS) (May 6, 1988) 22
50 Fed. Reg. 45,559 (1985) 4
51 Fed. Reg. 40,257 (1986) 4
58 Fed. Reg. 58,005 (1993) 4
K. Gideon, *Lawsuits and Settlements* (1995) 17-18
http//www.eeoc.gov/stats.charges.html 22
H.R. Rep. No. 728, 76th Cong., 1st Sess. (1939) 9, 10
H.R. Rep. No. 2447, 79th Cong., 2d Sess. (1946) 11, 16
Rev. Rul. 55-203, 1955-1 C.B. 114 13
Rev. Rul. 57-92, 1957-1 C.B. 306 13
Rev. Rul. 78-336, 1978-2 C.B. 255 13
Rev. Rul. 89-35, 1989-1 C.B. 280 ..... 13, 22
S. Rep. No. 734, 76th Cong., 1st Sess. (1939) 9, 10
S. Rep. No. 1862, 79th Cong., 2d Sess. (1946) 11, 16

Miscellaneous—Continued: Page

Statistics Division, Administrative Office of the United States Courts, *Judicial Business of the United States Courts: 1999 Annual Report of the Director* (2000) 22
SSA, Dep't of Health and Human Servs., SSR 83-7, 1981-1999 Soc. Sec. Rep. Ser. 18 (1983) 16-17
SSA, *Reporting Back Pay and Special Wage Payments to the Soc. Sec. Admin.*, Pub. No. 957 (Sept. 1997) 16-17
T.D. 6516, 25 Fed. Reg. 13,032 (1960) 12

In the Supreme Court of the United States

No.

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit in this case.

OPINIONS BELOW

The opinions of the court of appeals (App., *infra*, 1a-6a) and the district court (App., *infra*, 7a-12a) are unreported.

JURISDICTION

The judgment of the court of appeals was filed on May 10, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS AND REGULATIONS INVOLVED

The relevant portions of Sections 3101, 3111, 3121, 3301, and 3306 of the Internal Revenue Code, 26 U.S.C. 3101, 3111, 3121, 3301, and 3306, and of Sections 31.3101-2(c), 31.3101-3, 31.3111-2(c), 31.3111-3, 31.3121(a)-2, 31.3121(a)(1)-1(a)(2), 31.3301-2, and 31.3306(b)(1)-1 of the Treasury Regulations on Employment Taxes and Collection of Income Tax at Source, 26 C.F.R. 31.3101-2(c), 31.3101-3, 31.3111-2(c), 31.3111-3, 31.3121(a)-2, 31.3121(a)(1)-1(a)(2), 31.3301-2, and 31.3306(b)(1)-1, are set forth in the Appendix, *infra*, at 15a-26a.

STATEMENT

1. Respondent is one of the 26 major league baseball clubs that are parties to a collective bargaining agreement negotiated with the Major League Baseball Players Association. App., *infra*, 7a. The players association filed grievances claiming that, in 1986, 1987 and 1988, the clubs violated the free agency rights of the players under the collective bargaining agreement. *Id.* at 2a, 7a. An arbitration panel issued rulings in 1990 concluding that the clubs had interfered with the players' free agency rights and thereby depressed the players' salaries. To settle these grievances, the clubs agreed to pay $280 million into two accounts administered by a custodian for distribution to the players who had suffered damages. *Ibid.* The custodian was required to establish separate accounts for each of the clubs and, acting as agent for the clubs, was to deduct from the settlement payments any applicable federal income or employment taxes required to be withheld. C.A. App. 37, 90.

Under the agreed distribution plan, eight players who were employees of respondent during 1986, and fourteen players who were employees of respondent during 1987, received awards. The awards were paid in 1994. App., *infra*, 3a, 8a.[1] These payments aggregated $829,638 (including $219,638 denominated as interest) for violations of the collective bargaining agreement occurring in 1986 and $1,866,967 (including $409,119 denominated as interest) for violations occurring in 1987. *Id.* at 2a-3a, 8a; C.A. App. 11-12, 92.

As part of the Federal Insurance Contribution Act (FICA), Sections 3101(a) and (b) of the Internal Revenue Code "impose[] on the income of every individual" taxes to fund Social Security and Medicare "equal to [a percentage] of the wages (as defined in section 3121(a)) received by him with respect to employment." 26 U.S.C. 3101(a),(b). Similarly, Sections 3111(a) and (b) "impose[] on every employer" taxes to fund Social Security and Medicare "equal to [a percentage] of the wages (as defined in section 3121(a)) paid by him with respect to employment." 26 U.S.C. 3111(a), (b). For both employers and employees, the percentage of wages to be paid as the Social Security tax under Sections 3111(a) and 3101(a) was 5.7 percent in 1986 and 1987 and rose to 6.2 percent by 1994. 26 U.S.C. 3101(a), 3111(a). The percentage of wages paid by employers and employees as the Medicare tax under Sections

---

[1] One player who was not actually employed by respondent during 1987 also received an award in 1994 that was treated as attributable to 1987 under the settlement arrangement. The district court stated that this is because, even though "he was no longer in baseball in 1994, he was 'deemed' an employee of the last team to employ him—the Indians." App., *infra*, 8a n.1.

3101(b) and 3111(b) has been 1.45 percent since 1986. 26 U.S.C. 3101(b), 3111(b).

The term "wages" is defined for the purposes of the Social Security tax provisions (Sections 3101(a) and 3111(a)) to mean "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash," with certain exceptions. 26 U.S.C. 3121(a). As relevant here, wages do *not* include "that part of the remuneration which, after remuneration * * * equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) with respect to employment has been paid to an individual by an employer during the calendar year with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year." 26 U.S.C. 3121(a)(1).[2] This definition of wages also applied for purposes of Sections 3101(b) and 3111(b) in 1986 and 1987. 26 U.S.C. 3121(a) (1988). By 1994, however, when the settlement award payments were made in this case, "wages" had been defined so that the exclusion for amounts in excess of the contribution and benefit base no longer applied for purposes of the Medicare tax provisions (Sections 3101(b) and 3111(b)). See 26 U.S.C. 3121(a)(1).

In addition, as part of the Federal Unemployment Tax Act (FUTA), Section 3301 of the Internal Revenue Code "impose[s] on every employer * * * for each

[2] The contribution and benefit base is a fixed dollar amount for a particular year determined under the formula contained in Section 230 of the Social Security Act, 42 U.S.C. 430. In 1994, the base was $60,600. 58 Fed.Reg. 58,005 (1993). In 1986, the base was $42,000. 50 Fed.Reg. 45,559 (1985). In 1987, it was $43,800. 51 Fed.Reg. 40,257 (1986).

calendar year an excise tax * * * equal to * * * [a percentage] of the total wages * * * paid by him during the calendar year with respect to employment * * * ." 26 U.S.C. 3301. The percentage of wages constituting this tax was 6.0 percent in 1986 and 1987 (26 U.S.C. 3301 (1982)) and rose to 6.2 percent by 1994. 26 U.S.C. 3301. The term "wages" is defined for purposes of Section 3301 in the same manner as in Section 3121(a), except "wages" for unemployment tax purposes do not include "remuneration * * * after remuneration * * * equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year * * * ." 26 U.S.C. 3306(b).

2. When the amounts awarded to respondent's players were paid in 1994, FICA and income taxes were withheld from the amounts paid.[3] Respondent thereafter filed an employment tax return for the first quarter of 1994. That return reported employer and employee FICA taxes attributable to the settlement payments based on the entire amount of the awards made in 1994 and using the rates and annual ceilings on wages in effect for the 1994 year. App., *infra*, 2a-3a, 7a-8a; C.A. App. 13, 28, 92-93. Respondent also filed a return for the calendar year 1994 that reported the FUTA taxes attributable to the settlement payments based on the entire amount of the awards made in 1994 and using the rates and annual ceilings on wages in effect for the 1994 year. App., *infra*, 2a-3a, 7a-8a. Having remitted the withheld taxes, respondent then filed a claim for refund that sought to recover both the

[3] Under 26 U.S.C. 3102, 3402, employers are generally required to withhold from the wages of their employees the employee's share of the FICA tax and income taxes.

employer's share of the FICA and FUTA taxes it paid *and* the FICA taxes withheld from several employees who consented to join in the claim. C.A. App. 93. When the claim for refund was not granted within six months, respondent filed this tax refund suit in district court to recover the employer's share of the FICA taxes and the FUTA taxes that it paid. App., *infra*, 3a, 8a.[4]

Respondent raised several claims. First, that a portion of the award paid in 1994 was "interest," which is not subject to employment tax. Second, that the non-interest portion of the award paid in 1994 did not constitute "wages" within the meaning of the employment tax statutes. And, third, that, if any portion of the award paid in 1994 constituted "wages," it should be attributed to 1986 or 1987 (when the annual wage ceiling had been exceeded for the affected players) rather than to 1994, when the awards were paid. As a result, respondent claimed that no FICA or FUTA taxes were due from the 1994 awards. App., *infra*, 3a.

The parties stipulated (i) that the "interest" portion of the awards paid in 1994 did not constitute "wages" and (ii) that the remainder of the awards constituted back wages for the years 1986 and 1987. App., *infra*, 3a-4a. The parties then filed cross-motions for summary judgment that presented a single issue—whether, for FICA and FUTA tax purposes, the back wages paid by respondent are attributable to 1994, the year in which they were paid, or to 1986 and 1987, the years in which they would have been earned but for respondent's breach of the collective bargaining agreement. *Id.* at 4a.

---

[4] In this suit, respondent does not seek to recover the employee share of the FICA taxes. C.A. App. 1-18.

The government acknowledged in its brief to the district court that the prior decision of the Sixth Circuit in *Bowman* v. *United States*, 824 F.2d 528, 530 (1987), was controlling precedent on this issue in that court. In *Bowman*, the Sixth Circuit held that, for FICA tax purposes, "[a] settlement for back wages should not be allocated to the period when the employer finally pays but should be allocated to the periods when the regular wages were not paid as usual." *Id.* at 530 (internal quotation marks and citation omitted). Because other circuits have disagreed with the reasoning and holding of *Bowman*, however, the government's brief explained to the district court that the government desired to preserve that issue for appeal. App., *infra*, 10a. Acknowledging that "at least one court has disagreed with *Bowman*," the district court concluded that judgment in favor of respondent was "dictated" by the Sixth Circuit precedent that was controlling in that court. *Id.* at 10a-11a.

3. The government appealed and filed a petition for hearing en banc in view of the circuit conflict. The court of appeals denied the petition for en banc review and referred the case to a panel of the court. App., *infra*, 4a.

The panel affirmed. App., *infra*, 1a-5a. The panel noted that the government argued that the plain language of the FICA and FUTA statutes, the legislative history of those provisions, and the Treasury Regulations all demonstrate that *Bowman* was incorrectly decided and that "the government cites cases from our sister circuits that are at odds with our *Bowman* holding." *Id.* at 5a. The panel stated, however, that it was not required to address the merits of the government's contentions because, "[e]ven if we were

persuaded by the government's argument, we are bound by the *Bowman* decision." *Ibid.*

REASONS FOR GRANTING THE PETITION

This case presents a frequently recurring question regarding the proper treatment of back wages under the FICA and FUTA taxes. Due to the large volume of employment claims that can yield back wage awards under both federal and state laws, the resolution of the question presented in this case affects numerous employers and employees each year. Moreover, as the court of appeals acknowledged, cases in other circuits "are at odds with" the decision in this case (App., *infra*, 5a). Review by this Court is needed to resolve the disparate treatment thus afforded throughout the Nation to employers and employees under these conflicting decisions.

1. a. The court of appeals erred in holding that disbursements of back wages should be allocated for FICA and FUTA tax purposes to the years in which the wages were earned or should have been paid rather than to the year in which they actually were paid. Sections 3111(a) and (b) of the Internal Revenue Code impose the FICA taxes that fund Social Security and Medicare on "wages * * * paid" during the calendar year and Section 3301(a) imposes the FUTA tax on "wages * * * paid * * * during the calendar year." No exception to this express statutory rule is created for back wages.[5] Under the plain language of these

[5] Cf. 26 U.S.C. 3121(v)(2) (creating a special timing rule for compensation attributable to certain nonqualified deferred compensation plans).

statutes, the back wages are taxed in the year in which they are paid and *not* in the year in which the services were performed or would have been performed but for the wrongful conduct of the employer.

The legislative history of the pertinent statutory provisions shows that Congress specifically intended wages to be taken into account in the year that they are paid, regardless of when earned or when owed by the employer. As originally enacted in 1935, the Social Security Act provided that FICA tax rates, which gradually increased over the period from 1937 through 1948, applied "[w]ith respect to employment during the calendar year[]." Social Security Act, ch. 531, §§ 801, 804, 49 Stat. 636-637. In 1939, however, Congress amended FICA to provide that the rate of tax would no longer be applied on the basis of when the services were performed but would instead be applied "[w]ith respect to wages *received* during the calendar year[]" in the case of the employee (Social Security Act Amendments of 1939, ch. 666, § 601, 53 Stat. 1382 (emphasis added)) and "[w]ith respect to wages *paid* during the calendar year[]" in the case of the employer (Social Security Act Amendments of 1939, ch. 666, § 604, 53 Stat. 1383 (emphasis added)). The Report of the Committee on Ways and Means explains that, prior to the amendment, the statute "provide[d] that the rate of tax applicable to wages is the rate in effect at the time of the performance of the services for which the wages are paid" but that "[u]nder the amendment *the rate applicable would be the rate in effect at the time that the wages are paid and received without reference to the rate which was in effect at the time the services were performed.*" H.R. Rep. No. 728, 76th Cong., 1st Sess. 57-58 (1939) (emphasis added). See also S. Rep. No. 734, 76th Cong., 1st Sess. 70-71 (1939). A corre-

sponding change was also made to the provision of the FUTA that specified how its tax rate was applied. Social Security Act Amendments of 1939, ch. 666, § 608, 53 Stat. 1387. In adopting the new rule, Congress emphasized that, "[w]ith both the old-age-insurance tax [FICA] and the unemployment compensation tax [FUTA] on the wages paid basis, the keeping of records by employers will be simplified." S. Rep. No. 734, *supra*, at 75-76; H.R. Rep. No. 728, *supra*, at 62-63.

The legislative history of similar changes in the provisions that place an annual ceiling on wages subject to FICA and FUTA tax (currently in 26 U.S.C. 3121(a) and 3306(b)) also reflects the clear intent of Congress that the FICA and FUTA taxes are to be determined on a wages-paid basis. Prior to the Social Security Act Amendments of 1946, ch. 951, 60 Stat. 978, the Social Security Act had allocated wages to the year in which services were performed in applying the maximum wage base for FICA and FUTA tax purposes.[6] In 1946, Congress amended the annual ceiling provisions to change the basis upon which the ceiling was measured from one that looked to *services performed* during the year to one that looked to *wages paid* during the year. Social Security Act Amendments of 1946, ch. 951, §§ 412(a), (b), 60 Stat. 989. The reports of the Senate Finance Committee and the House Committee on Ways

[6] As originally enacted in 1935, the Social Security Act included an annual wage ceiling for the FICA tax, but did not include one for the FUTA tax. Social Security Act, ch. 531, §§ 811(a), 901, 907(b), 49 Stat. 639, 642. In 1939, Congress amended the definition of wages for FUTA tax purposes to include an annual wage ceiling that tracked the annual wage ceiling applicable to FICA, which at that time allocated wages to the year in which services were performed in applying the maximum wage base. Social Security Act Amendments of 1939, ch. 666, § 614, 53 Stat. 1392-1393.

and Means explained that, "[u]nder the definition of the term contained in existing law there is excluded from 'wages', for [FICA and FUTA tax] purposes, all remuneration with respect to employment during any calendar year paid to an individual by an employer (irrespective of the year of payment) after remuneration equal to $3,000 has been paid to such individual by such employer with respect to employment during such year." S. Rep. No. 1862, 79th Cong., 2d Sess. 35 (1946); H.R. Rep. No. 2447, 79th Cong., 2d Sess. 35 (1946). These reports further explained that the new legislation "amends such definitions, effective January 1, 1947, to constitute as the yardstick the *amount paid* during the calendar year (with respect to employment to which the taxes under the code are applicable), *without regard to the year in which the employment occurred.*" S. Rep. No. 1862, *supra*, at 35 (emphasis added); H.R. Rep. No. 2447, *supra*, at 35 (emphasis added). The reports concluded that, "in applying the $3,000 limitation on wages, the employer, employee, and those administering the taxes, may, beginning with the calendar year 1947, look only to the amount of remuneration paid by the employer to the employee during the calendar year, and exclude all remuneration paid during the calendar year after $3,000 has been paid during the year with respect to * * * the employment with respect to which the taxes imposed by * * * the Federal Insurance Contributions Act are applicable[.]" S. Rep. No. 1862, *supra*, at 36; H.R. Rep. No. 2447, *supra*, at 35.[7]

[7] After the changes enacted in the 1946 Amendments, the FICA and FUTA tax provisions were recodified in the Internal Revenue Code of 1954 and given their current section numbers. Although the applicable tax rates and the amounts of the annual

Consistent with the language of these statutes and their legislative history, Treasury Regulations have long specified that the relevant year for determining the FICA tax is the year in which the wages are paid or received.[8] These regulations specify that "[t]he employee tax attaches at the time that the wages are received by the employee" (26 C.F.R. 31.3101-3) and that "[t]he employee tax is computed by applying to the wages received by the employee the rate in effect at the time such wages are received" rather than during "the year in which the services were performed" (26 C.F.R. 31.3101-2(c) & Example). The regulations further provide that "[t]he employer tax attaches at the time that the wages are paid by the employer" (26 C.F.R. 31.3111-3) and that "[t]he employer tax is computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid" (26 C.F.R. 31.3111-2(c)).[9] The regulations that interpret the statu-

---

wage ceilings have changed since the enactment of the 1954 Code, as relevant here, the FICA and FUTA provisions involved in this case have remained substantially the same since 1946. See 26 U.S.C. 3101, 3111, 3121(a), 3301, 3306.

[8] In 1960, the Treasury Regulations governing FICA and FUTA were consolidated and republished with their current section numbers. T.D. 6516, 25 Fed. Reg. 13,032 (1960). The substance of these regulations traces back to earlier promulgations. See Treas. Reg. 107, § 403.228(a) (as amended by T.D. 5566, 1947-2 C.B. 148); Treas. Reg. 106, § 402.228(a) (as amended by T.D. 5566, 1947-2 C.B. 148); Treas. Reg. 106, §§ 402.301, 402.302, 402.303, 402.401, 402.402, 402.403 (1940).

[9] As to when wages are paid and received, Treasury regulations provide that "[i]n general, wages are received by an employee at the time that they are paid by the employer to the employee. Wages are paid by an employer at the time that they are actually or constructively paid unless under paragraph (c) of this section [which concerns specified types of minor cash pay-

tory annual ceiling on wages subject to FICA (26 U.S.C. 3121(a)) further provide that this limitation "relates to the amount of remuneration received during any 1 calendar year for employment after 1936 and not to the amount of remuneration for employment performed in any 1 calendar year." 26 C.F.R. 31.3121(a)(1)-1(a)(2). Applying the plain language of these statutes and regulations, the Treasury has consistently taken the position that back wages are to be taken into account for FICA purposes in the year they are actually paid. Rev. Rul. 55-203, 1955-1 C.B. 114; Rev. Rul. 89-35, 1989-1 C.B. 280. See also Rev. Rul. 57-92, 1957-1 C.B. 306; Rev. Rul. 78-336, 1978-2 C.B. 255.

The Treasury Regulations that interpret FUTA are to the same effect. The FUTA regulations state that "[t]he tax for any calendar year is measured by the amount of wages paid by the employer during such year" (26 C.F.R. 31.3301-2) and that "[t]he tax is computed by applying to the wages paid in a calendar year * * * the rate in effect at the time the wages are paid" (26 C.F.R. 31.3301-3(b)). The FUTA regulations addressing the annual wage ceiling similarly provide that "the term 'wages' does not include that part of the remuneration paid within any calendar year by an employer to an employee which exceeds the first $3,000 of remuneration * * * paid within such calendar year by such employer to such employee for employment performed for him at any time after 1938." 26 C.F.R. 31.3306(b)(1)-1(a)(1).[10] In addition, the regulations

---

ments that are not involved in this case] they are deemed to be subsequently paid." 26 C.F.R. 31.3121(a)-2(a).

[10] Since these regulations were issued, the annual wage ceiling has been raised to $7,000. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 271(a), 96 Stat. 554; Unem-

addressing the annual wage ceiling expressly provide that the ceiling applies "to the amount of remuneration paid during any one calendar year for employment * * * and not to the amount of remuneration for employment performed in any one calendar year." 26 C.F.R. 31.3306(b)(1)-1(a)(2).

b. It is well established that "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Cottage Savings Ass'n* v. *Commissioner*, 499 U.S. 554, 561 (1991) (internal quotation marks and citations omitted); see also *Atlantic Mutual Ins. Co.* v. *Commissioner*, 523 U.S. 382, 389 (1998); *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 488 (1979).

In the present case, the court of appeals did not address the agency's consistent interpretation of these controlling statutory provisions. Nor did the court provide any analysis or discussion of the text of the statutes or their legislative history. Instead, the Sixth Circuit rejected the government's position solely on the basis of that court's prior decision in *Bowman*. App., *infra*, 5a. In *Bowman*, however, the court had *also* failed to address the clear legislative history that demonstrates that, after 1946, Congress did not intend to allocate back wages to the year in which services were performed. The court similarly failed in *Bowman* to reconcile its holding with the plain language of the statutes and the applicable Treasury Regulations. Instead, in *Bowman*, the court of appeals based its hold-

---

ployment Compensation Amendments of 1976, Pub. L. No. 94-566, § 211(a), 90 Stat. 2676; Employment Security Amendments of 1970, Pub. L. No. 91-373, § 302, 84 Stat. § 713.

ing that back wages are to be allocated to the years in which services were performed, rather than to the year in which the back wages were paid, solely on the theory that that result is required by the decision of this Court in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946). See 824 F.2d at 530.

The *Nierotko* case involved an application of the Social Security Act provisions that predated the changes made to these statutes by Congress in 1946. In *Nierotko*, an employee was awarded back pay under the National Labor Relations Act for the period from February 2, 1937, to September 25, 1939, for a wrongful discharge due to his union activities. The back pay was paid on July 18, 1941. The principal issue for decision was whether that back pay was to be treated as "wages" in determining the employee's entitlement to benefits under the Social Security Act of 1935. The Court first concluded that back pay constitutes "wages" for purposes of the Act. 327 U.S. at 360-370. The Court then stated that, "[i]f, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods when the regular wages were not paid as usual." *Id.* at 370.

The *Nierotko* case was decided under the original provisions of the Social Security Act of 1935 that defined "wages" as "remuneration for employment," subject to a $3,000 wage ceiling "with respect to employment during any calendar year." Social Security Act of 1935, ch. 531, § 210(a), 49 Stat. 625. See 327 U.S. at 360. The term "employment" was further defined in that Act as "any service * * * performed * * * by an employee for his employer." Social Security Act of 1935, § 210(b), 49 Stat. 625. The statute applied in *Nierotko* thus used services performed, rather than payments received, to

define the annual wage ceiling for benefit purposes. See pages 9-10, *supra*.

In 1946, however, Congress amended the Social Security Act to change the annual "wage" ceiling for benefit purposes. For "remuneration * * * with respect to employment * * * paid to an individual during any calendar year *after 1946*," the annual wage ceiling was based upon "remuneration * * * *paid* to such individual during such calendar year." Social Security Act Amendments of 1946, Pub. L. No. 79-719, § 414(a)(3), 60 Stat. 991 (emphasis added). The legislative reports for the 1946 Act plainly state that the annual wage ceiling for benefit computation purposes (and for FICA and FUTA tax purposes) was thereafter to be determined based upon the date of payment and "without regard to the year in which the employment occurred." S. Rep. No. 1862, *supra*, at 35, 37; H.R. Rep. No. 2447, *supra*, at 35-36. The statutory scheme considered in *Nierotko* thus obviously differed in this precise critical respect from the statutory provisions that have been in effect since 1946—the provisions that are involved in this case.[11]

---

[11] In a program policy statement, the Social Security Administration (SSA) has indicated that, for benefit computation purposes, it will continue to apply the *Nierotko* rule to one particular type of back wages—"back pay under a statute." SSA, Dep't of Health and Human Servs., SSR 83-7, 1981-1991 Soc. Sec. Rep. Ser. 18 (1983); see also 20 C.F.R. 404.1242. This policy statement applies only for benefit computation purposes; it does not apply for tax purposes. SSA, *Reporting Back Pay and Special Wage Payments to the Soc. Sec. Admin.*, Pub. No. 957 (Sept. 1997), at 1. ("The Social Security Administration (SSA) has special rules for back pay * * * for social security coverage and benefit purposes only."). Indeed, the SSA has noted that, under the rule that applies for tax purposes under the Social Security Act, "employers are liable for Federal Insurance Contribution Act tax payments on back pay on the basis of when the payment is made * * *." SSR 83-7, at *1; accord Pub. No. 957, *supra*, at 2.

Moreover, as the Sixth Circuit acknowledged in the *Bowman* case, the decision in *Nierotko* "is factually distinguishable from the present case" because it "involved back wages in the benefits context as opposed to the taxation context." 824 F.2d at 530. The considerations relevant for benefits purposes are not necessarily the same as those for tax purposes. As this Court observed in *Flemming* v. *Nestor*, 363 U.S. 603, 609 (1960), "eligibility for benefits, and the amount of such benefits, do not in any true sense depend on contribution to the program through the payment of taxes, but rather on the earnings record of the primary beneficiary." See also note 11, *supra*. In determining an employee's eligibility for benefits, and the amount thereof, an allocation of an award of back wages to the periods of employment to which such back wages relate may be consistent with the policy of providing security to employees in retirement. Absent such an allocation, an employee may not obtain credit for a sufficient number of quarters to allow him to collect benefits and the amount of benefits awarded may similarly be affected.

No similar policy considerations are at stake in the tax context. Indeed, taxing back wages in the year actually paid does not routinely result in additional FICA and FUTA tax liability, even though it appears to do so in this particular case. To the contrary, in the common situation in which, during the year of payment (as opposed to the year to which such back wages could be attributed), the employee had already reached the maximum wage limit, *less* tax would be owed when the back wages are taxed in the year paid. As one

commentator has pointed out, "[t]he *Bowman* case will seldom provide an advantageous result for current [taxpayers]." K. Gideon, *Lawsuits and Settlements* § 1101.4, at 262 (1995). Moreover, because of the complexities of restating tax liabilities for cash basis taxpayers from the year of payment to former periods of time, "*Bowman* is not only expensive for most taxpayers, it also imposes substantial administrative burdens on the IRS." *Id.* at 263 n.42.

2. The court of appeals correctly noted in this case that decisions in other circuits "are at odds with [its] *Bowman* holding" (App., *infra*, 5a).[12] For example, in *Hemelt* v. *United States*, 122 F.3d 204 (4th Cir. 1997), the taxpayers had received a payment in settlement of a class action suit under Section 502 of the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829. The ERISA suit had alleged that the taxpayers' employer had improperly fired them to prevent them from qualifying for pension benefits. The taxpayers contended that the settlement payment they received from the ERISA case did not represent "wages" subject to the FICA tax and further contended, relying on the Sixth Circuit's decision in *Bowman* (Appellant's Br. 46), that, even if the payment constituted "wages," it must be allocated to the years the wages would have been earned instead of to the year the payment was received. 122 F.3d at 210. The Fourth Circuit first concluded that the settlement

[12] The decision in *Bowman* has been cited favorably in dictum in *Johnston* v. *Harris County Flood Control District*, 869 F.2d 1565, 1580 (5th Cir. 1989), cert. denied, 493 U.S. 1019 (1990), and has been followed by a district court in another circuit. *San Francisco Baseball Associates L.P* v. *United States*, 88 F. Supp.2d 1087, 1094-1095 (N.D. Cal. 2000), cross-appeals pending, Nos. 00-15750 & 00-15890 (9th Cir).

payment represented back pay for a wrongful termination of employment and therefore constituted "wages" for purposes of the FICA tax. *Id.* at 209-210. The court then held that the taxpayer's reliance on the *Bowman* decision was "meritless." *Id.* at 210.[13] Without discussing the *Bowman* opinion directly, the court rejected the reasoning of that decision because "[i]t is clear under the Treasury Regulations that 'wages' are to be taxed for FICA purposes in the year in which they are received." *Ibid.* (citing 26 C.F.R. 31.3121(a)-2(a)).[14] See also *Mazur* v. *Commissioner*, 986 F. Supp. 752, 755 (W.D.N.Y. 1997) (concluding that the Sixth Circuit erred in *Bowman* by failing to defer to the long-standing Treasury Regulations); page 13, *supra*.

In *Walker* v. *United States*, 202 F.3d 1290 (2000), the Tenth Circuit also rejected the analysis and conclusion of the *Bowman* decision. In that case, in the years 1992 through 1995, a lawyer received a portion of a contingency fee payment owed in connection with an antitrust lawsuit that had been filed in 1972 and settled in 1975. The lawyer paid Self-Employment Contributions Act (SECA) taxes imposed under 26 U.S.C. 1401 on the amounts received. He then brought a refund suit, claiming that the amounts received during the years 1992 through 1995 should be allocated to the years in which the services were performed (1971

[13] The court of appeals further noted in the *Hemelt* case that the taxpayers had provided no evidence of how the court should allocate the award among the prior years and that the court therefore "could not undertake such allocation even if [it] were allowed to do so." 122 F.3d at 210-211.

[14] The court also rejected the taxpayer's additional claim that this settlement payment was excluded from the federal income tax under 26 U.S.C. 104(a)(2) as damages received on account of personal injury. See 122 F.3d at 209-210.

through 1975). In urging that claim, he relied on the decision of this Court in *Nierotko* and the decision of the Sixth Circuit in *Bowman*. For the reasons we have described (pages 15-16, *supra*), the Tenth Circuit found the decision in *Nierotko* "inapposite" and the decision in *Bowman* "unpersuasive." 202 F.3d at 1293. The Tenth Circuit, like the Fourth Circuit in *Hemelt*, relied significantly on the fact that the governing Treasury regulations specify that wages are subject to the tax when received, not when the services are rendered. *Id.* at 1292-1293.

The *Bowman* decision is also inconsistent in principle with *In re Freedomland, Inc.*, 480 F.2d 184 (2d Cir. 1973), aff'd *sub nom. Otte* v. *United States*, 419 U.S. 43 (1974). In that case, former employees of a bankrupt corporation filed wage claims for services performed prior to the filing of the bankruptcy petition. The district court held that the bankruptcy trustee was required to withhold federal income and employment taxes with respect to such claims. 419 U.S. at 46. The district court also held that the government was not required to file a proof of claim to recover the withheld taxes and that the government claim should be given fourth priority. *Id.* at 46-47. The court of appeals affirmed these holdings and rejected the trustee's assertion that requiring the trustee to withhold taxes would create an administrative "parade of horribles." 480 F.2d at 188. The court of appeals pointed out that most wage earners are on a cash basis and report their income taxes when their wages are received and that the "[w]ithholding of social security taxes is also done 'by deducting the amount of the tax from the wages *as and when paid.*'" *Id.* at 189 n.8 (quoting 26 U.S.C. 3102(a)). The court further noted that "[t]he taxes are by law calculable only when the wage claims are paid

and not until then." *Id.* at 190. The Second Circuit thus recognized that back pay is to be taken into account for FICA tax purposes in the year the payment is received, rather than the year for which the payment was owed.

This Court affirmed. 419 U.S. at 58. The Court first concluded that, although "the payments to the wage claimants [were] * * * made after the employment relationship terminated," they were still "wages" for purposes of income tax withholding (419 U.S. at 49) and that "[t]he situation is the same with respect to FICA withholding" (419 U.S. at 51). The Court then observed that "Section 3102(a) of the Internal Revenue Code, 26 U.S.C. § 3102(a), provides that the tax is to be collected by the employer by deducting 'from the wages as and when paid.'" 419 U.S. at 51. The Court therefore concluded that "the payments clearly are 'wages' under that statute, even though again, at the time of payment, the employment relationship between the bankrupt and the claimant no longer exists." *Ibid.* The Court stated that this conclusion was also supported by the long-standing regulations that "consistently have been to this effect." *Ibid.* The Court emphasized that the payments became subject to FICA tax when paid, rather than when earned, for "[l]iability for the taxes accrues only when the wage is paid." *Id.* at 55 (citing 26 U.S.C. 3402(a), 3101(a)). The Court explained that "[t]he wages that are the subject of the wage claims, although earned before bankruptcy, were not paid prior to bankruptcy. Freedomland [the debtor] had incurred no liability for the taxes. Liability came into being only during bankruptcy. The taxes do not partake, therefore, of the nature of debts of the bankrupt for which proofs of claim must be filed." 419 U.S. at 55. While neither the court of appeals nor this Court was faced in *In re Freedomland* with the precise question presented

in this case, the conclusion in that case that, under the plain text of these statutes, FICA tax liability arises at the time the wages are paid, rather than at the time the work to which the wage claim relates is performed, directly supports the government's position in this case.

3. The Internal Revenue Service has announced that it does not acquiesce in, and will not follow, the decision in *Bowman*. AOD 1988-006, 1988 WL 570743 (IRS) (May 6, 1988); Rev. Rul. 89-35, 1989-1 C.B. 280. In view of the conflict that exists among the circuits on the question presented in this case, employers that are subject to a judgment for back wages, or that enter into a settlement of a claim for back wages, lack adequate guidance as to how they should compute the FICA and FUTA taxes attributable to such payments. Moreover, either choice made by the employer is likely to generate controversy and result in litigation—instituted by the government if the *Bowman* rule is followed or by the employer or employee if the cases rejecting *Bowman* are followed.

Statistics compiled by the Director of the Administrative Office of the United States Courts show that over the five-year period from 1995 to 1999, more than 100,000 private civil rights cases involving employment claims were commenced in the federal district courts. Statistics Division, Administrative Office of the United States Courts, *Judicial Business of the United States Courts: 1999 Annual Report of the Director* 140 (2000). The Enforcement Statistics of the Equal Employment Opportunity Commission show that, in *each* of the years 1992 through 1999, more than 70,000 charges of unlawful employment practices were received.[15] While

[15] These statistics can be accessed on the internet at http//www.eeoc.gov/stats/charges.html.

many of these claims may not result in a judgment favorable to the claimant or a settlement in which back pay is paid, there are undoubtedly significant numbers of such claims that do. In addition, as the cases cited in this petition illustrate, awards of back wages also occur in ERISA and bankruptcy cases and many other settings.

Moreover, the specific context in which this case arose has already led to intensive litigation in the lower courts. Disputes over the tax treatment of the distributions from the collective bargaining settlement involved in this case have, to this date, already spawned eight other tax refund suits raising the *Bowman* issue. See *San Francisco Baseball Assocs. L.P* v. *United States*, 88 F. Supp. 2d 1087 (N.D. Cal. 2000), cross-appeals pending, Nos. 00-15750 & 00-15890 (9th Cir.); *The Minnesota Twins Partnership* v. *United States*, No. 00-CV-356ADM/AJB (D. Minn.); *The Boston Red Sox Baseball Club* v. *United States*, No. 00-CV-10312 (D. Mass.); *Kansas City Royals Baseball Corp.* v. *United States*, Nos. 00-0105-CV-W-3 (W.D. Mo.); *St. Louis Cardinals, L.P.* v. *United States*, No. 4:00-CV-00138-CAS (E.D. Mo.); *Baseball Club of Seattle, L.P.* v. *United States*, No. C99-2061-Z (W.D. Wash.); *San Diego Padres Baseball Partnership* v. *United States*, No. 99-CV-0828W (LSP) (S.D. Cal.); *The Phillies, a Pennsylvania Limited Partnership* v. *United States*, No. 99-CV-4054 (E.D. Pa.). This one single settlement agreement may lead to 17 additional suits if each of the remaining clubs chooses to litigate the issue.

The question presented in this case is thus manifestly a recurring issue of substantial importance in the administration of the tax laws. Resolution of this commonly recurring issue is needed to avoid continuing uncertainty and uneven application throughout the Nation

of these widely applicable FICA and FUTA tax provisions.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General
PAULA M. JUNGHANS
Acting Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
KENNETH L. GREENE
ROBERT W. METZLER
Attorneys

AUGUST 2000

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 99-3410

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA,
DEFENDANT-APPELLANT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF OHIO

[Filed: May 10, 2000]

OPINION

Before: SUHRHEINRICH, COLE, Circuit Judges; and QUIST, District Judge.*

PER CURIAM. The United States appeals from the judgment of the district court in which the court found that an award of back wages is taxed for the purposes of the Federal Insurance Contribution Act (FICA), 26 U.S.C. §§ 3101-3128, and Federal Unemployment Tax

---

* The Honorable Gordon J. Quist, United States District Court for the Western District of Michigan, sitting by designation.

Act (FUTA), 26 U.S.C. §§ 3301-3311, in the year in which those wages were earned rather than the year in which the award of back wages was actually paid. For the following reasons, we AFFIRM the district court's judgment.

I.

The parties stipulated to the facts of this case before the district court, which we briefly summarize here. Major League Baseball Clubs (the "Clubs") and the Major League Baseball Players Association ("MLBPA") were involved in three separate grievances in 1990, wherein the MLBPA claimed that the Clubs breached the Collective Bargaining Agreement ("CBA") with respect to free agency rights of the baseball players in 1986, 1987 and 1988. After an arbitration panel issued a series of rulings adverse to the Clubs, the Clubs and the MLBPA settled their grievances on December 21, 1990. The settlement required the Clubs to contribute $280 million to a custodial account for distribution to affected players according to the MLBPA framework approved by the arbitration panel.

The Cleveland Indians Baseball Company's ("Indians") share of the settlement fund was $610,000 for the 1986 season and $1,457,848 for the 1987 season. The Indians received the funds in 1994 and distributed those funds to the affected players—eight players who were employed in 1986 and fifteen players who were employed in 1987. Unsure as to the tax treatment of these distributions, the Indians paid FICA and FUTA taxes on the total funds as if the payments were wages for services rendered in 1994. In other words, the Indians paid FICA and FUTA taxes on the funds as if

they were actually wages received by the players in 1994, the year of distribution. The Indians paid these tax obligations in April 1994 and January 1995. None of the affected players, however, performed services for the Indians in 1994 or 1995. The Indians filed this instant action seeking reimbursement of the FICA and FUTA taxes paid to the United States.

The Indians sought a refund of FICA and FUTA taxes claiming that, (1) a portion of the funds paid to the Indians and disbursed to its former players constituted non-taxable interest; and (2) the non-interest portion was not taxable because the funds were damages for the wrongful breach of the CBA and not wages for services rendered. Finally, even if the payments constituted wages for services rendered rather than interest and damages, the Indians argued that they should have paid taxes at the 1986 and 1987 tax rates applicable when the services were rendered. Because the 1986 and 1987 FICA and FUTA taxes of each of the affected players were already paid to the maximum required amount, the Indians asserted that they are entitled to a full refund if the payments were determined to be wages for services rendered in 1986 and 1987.

The government initially disputed the Indians's claims. Both parties eventually agreed, however, that $629,000 of the payments from the settlement fund to affected players constituted interest and were not subject to FICA and FUTA taxes. Thus, the Indians were entitled to a refund for taxes paid on the interest portion of the settlement. The parties also agreed that the remaining portion of the payments, approximately $2 million, constituted back-wage payments, earnings

that would have been paid in 1986 and 1987 but for the Clubs' breach of the CBA. The issue presented to this court is the tax year applicable to these back-wage payments made in 1994 for services rendered in the 1986 and 1987 baseball seasons.

In the district court, the government and the Indians agreed that our decision in *Bowman v. United States*, 824 F.2d 528 (6th Cir.1987) directly addressed this precise issue. The *Bowman* court held that "a settlement for back wages should not be allocated to the period when the employer finally pays but 'should be allocated to the periods when the regular wages were not paid as usual.'" 824 F.2d at 530 (quoting *Social Security Bd. v. Neirotko*, 327 U.S. 358, 370 (1946)). Following *Bowman*, the district court entered judgment in favor of the Indians and ordered the United States to refund the FICA and FUTA taxes paid on the settlement disbursements designated as back wages, including interest from the dates on which the payments were made.

The United States sought en banc reversal of the *Bowman* decision. This court declined the en banc petition and the case was referred to this panel.

II.

Typically, statutory interpretations such as those presented in this appeal are reviewed *de novo*. *See Williams v. Coyle*, 167 F.3d 1036, 1038 (6th Cir. 1999).

Here, our precedent clearly indicates that the statutory provision in question requires settlements for back wages to be allocated to the period in which they were earned or should have been paid, and not to the

period in which the back wages were actually disbursed. *See Bowman*, 824 F.2d at 530. The government contends that *Bowman* was wrongly decided, arguing that the plain language, legislative history and applicable FICA and FUTA Treasury Regulations demonstrate that back wages are subject to tax in the year in which payment is made and not in which the services were rendered. In addition, the government cites cases from our sister circuits that are at odds with our *Bowman* holding. Despite these arguments, the government "agrees with taxpayer that the issue presented in this case was decided in *Bowman*." Appellant Reply Br. at 1.

Even if we were persuaded by the government's argument, we are bound by the *Bowman* decision. It is firmly established that one panel of this court cannot overturn a decision of another panel; only the court sitting en banc can overturn such a decision. *See United States v. Smith*, 73 F.3d 1414, 1418 (6th Cir. 1996). "The earlier determination is binding authority unless a decision of the United States Supreme Court mandates modification or this Court sitting en banc overrules the prior decision." *United States. v. Moody*, 206 F.3d 609,—(6th Cir. 2000) (citing *Salmi v. Secretary of HHS*, 774 F.2d 685, 689 (6th Cir.1985)). Accordingly, following *Bowman*, we reject the government's argument and affirm the district court's judgment that FUTA and FICA taxes paid on the back wage disbursements should have been paid as if earned in 1986 and 1987.

III.

For the foregoing reasons, we **AFFIRM** the district court's judgment.

APPENDIX B

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CHIO
EASTERN DIVISION

Case No. 1:96-CV-2240

CLEVELAND INDIANS BASEBALL CO., PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: Jan. 25, 1999]

MEMORANDUM & OPINION

By this action, the plaintiff, Cleveland Indians Baseball Company (the Indians), seeks a refund from the United States of taxes paid pursuant to the Federal Insurance Contribution Act (FICA) and the Federal Unemployment Tax Act (FUTA). Before the Court are the parties' Cross-Motions for Summary Judgment on Stipulated Facts. For the reasons briefly set forth below, the Indians' motion is GRANTED, the Government motion is DENIED and judgment is entered in favor of plaintiffs for a total of $97,202.20, plus interest.

I.

The FICA and FUTA taxes at issue were paid by the Indians in April 1994 and January 1995, respectively. The taxes were premised on payments made by the Indians in 1994 to certain of its former players, specifically eight players who were employed by the Indians in 1986 and fifteen players employed by the plaintiff in 1987[1] The money for these payments came from a fund created pursuant to a settlement between the Union and twenty-six Major League Baseball Clubs after an initial arbitration decision finding that the Clubs had violated the collective bargaining agreement between them.[2]

The Indians share of the settlement fund (which totaled $280 million) was $610,00.00 for the 1986 season and $1,457,848.00 for the 1987 season. The Indians received its share of the fund in 1994 and proceeded to disburse those funds to its effected [sic] players in that same year. Because it was unsure of the tax treatment to be afforded these funds, the Indians paid FICA and FUTA taxes on the total funds disbursed as if the funds represented wages paid for services rendered *and* paid those taxes premised upon the tax obligation which

---

[1] Of these fifteen, one was not actually employed by the Indians in 1987. Because he was no longer in baseball in 1994, he was "deemed" an employee of the last team to employ him-the Indians.

[2] Specifically, the arbitration panel found that the Clubs breached Article XVIII(H) of the bargaining agreement, which prohibits the Clubs from taking concerted action to interfere with the free agency rights of their players. The arbitrators concluded that the Clubs violated this provision of the bargaining agreement by their conduct at the close of the 1985 and 1986 playing seasons, thereby affecting the market and artificially depressing salaries of would-be free agents in the subsequent seasons.

would have been applicable in the year in which the funds were actually received by the players, 1994. The Indians subsequently filed this action seeking reimbursement of all sums paid to the United States.

II.

The Indians initially contended that it was entitled to a full refund for the following reasons:

> 1. A portion of the funds paid to the Indians and disbursed to its former players ($629,000.00) constituted non-taxable interest;
>
> 2. The remaining portion of the funds (approximately $2,000,000.00) were non-taxable payments because they represented damages for a wrongful breach of the bargaining agreement, not wages for services performed; and
>
> 3. Even if the payments constituted wages for services rendered (and not interest or damages), they should have been taxed at the 1986 and 1987 tax rate, respectively, requiring reimbursement of all payments, because the FICA and FUTA obligations of the effected [sic] players had been satisfied previously for those tax years.

The government initially disputed all three points, arguing that the payments were all for wages and that FICA and FUTA taxes must be paid in the year in which wages actually are received, not the year in which they were earned or came due.

The parties eventually settled two of their disputes, though not the primary one. Thus, the parties agreed that $629,000.00 of the payments made by the Indians

out of the settlement fund constituted interest payments to which FICA and FUTA were inapplicable, requiring a reimbursement of at least $13,071.10 of the taxes paid in 1994. The parties also agreed that all remaining sums *did* constitute back-pay wage payments, reflecting monies that would have been earned in 1986 and/or 1987 but for the Clubs' joint breach of the bargaining agreement. The remaining issue, on which the parties continue to disagree, is the question of to which tax year those wages are attributable for FICA and FUTA purposes.

Interestingly, however, this remaining area of dispute is really a disagreement over what the law ought to be; the parties do not seriously dispute what the law is-at least in this Circuit. Thus, the Indians cite to and rely upon the Sixth Circuit's decision in *Bowman v. United States*, 824 F.2d 528 (6th Cir.1987) (Merritt, Martin and Brown), where the panel unanimously concluded that, "[A] settlement for back wages should not be allocated to the period when the employer finally pays but 'should be allocated to the periods when the regular wages were not paid as usual.'" *Id.* At 530, quoting *Social Security Bd. v. Neirotko*, 327 U.S. 358, 370 (1946). Based on this authority, which the Indians contend is eminently sound, the Indians assert that this Court has no choice but to (1) follow *Bowman*, (2) allocate the wages paid in 1994 to 1986 and 1987-years in which the maximum FICA and FUTA taxes had already been paid, and (3) enter judgment in the Indians favor for a full refund of all taxes paid in connection with the disbursement of settlement funds in 1994.

The government's response to *Bowman* is pointedly honest. The government concedes that *Bowman* is fac-

tually "indistinguishable from this case" and that, "under the facts in this case, the Court appears bound to follow the decision in *Bowman*." (Gov't Brief at 4-5). The government contends, however, that the *Bowman* decision was wrongly decided" and that, presumably, it will be able to convince the Sixth Circuit of that fact on appeal. Thus, the government explains in detail in its brief to this Court why it believes Congress intended FICA and FUTA obligations to apply in, or, in the language of *Bowman*, to be allocated to, the tax years in which wages actually are disbursed by the employer. The government notes that it must engage in this exercise, despite its earlier concessions regarding this Court's apparent lack of options in the face of *Bowman*, "to preserve the record for appeal." (Gov't. Brief at 5).

Apparently not fully content with the prospect of an appeal from the record as it stands, moreover, the government goes on to ask this Court to "consider" its arguments regarding the wisdom of *Bowman* and "issue a decision which reflects what this Court would do if it were given the privilege of a clean slate upon which to draw its decision." (Gov't. Brief at 5). While this Court, of course, has considered all of the government's arguments, and has examined all authority cited by both parties, it is disinclined to issue what is essentially an advisory opinion, particularly in the face of a clear, unanimous directive from a distinguished Sixth Circuit panel.

Accordingly, this Court will follow the course proposed by the Indians and dictated by *Bowman*. The government will be free on appeal to point out that many of the arguments presented here were not (apparently) presented to the *Bowman* panel and that at

least one court has disagreed with *Bowman* since that decision was issued, instead applying the allocation the government urges here. Judgment will be entered in favor of the Indians and the United States ordered to refund the $97,202.20 in FICA and FUTA taxes paid in connection with the 1994 settlement disbursements, plus interest from the dates on which such payments were made, at the rate dictated by Internal Revenue Code Sections 6621 and 6622.[3]

IT IS SO ORDERED.

/s/ KATHLEEN M. O'MALLEY
KATHLEEN M. O'MALLEY
United States District Judge

[3] This total encompasses both the taxes paid on the interest portion of the disbursements and the taxes paid on the back-pay or wage portion thereof.

APPENDIX C

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

Case No. 1:96-CV-2240

CLEVELAND INDIANS BASEBALL CO., PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

[Filed: Jan. 25, 1999]

ORDER

For the reasons set forth in the Memorandum and Opinion issued in conjunction with this Order, judgment is hereby entered in favor of plaintiff, the Cleveland Indians Baseball Company, and against defendant, the United States of America for refunds of (1) FICA taxes in the amount of $96,250.20, plus interest from April 30, 1994 at the rate dictated by I.R.C. §§ 6621 and 6622 and (2) $952.00 in FUTA taxes, plus interest from January 31, 1995 at the rate fixed by I.R.C. §§ 6621 and 6622.

Based on this judgment, the case is hereby dismissed.

IT IS SO ORDERED.

/s/ KATHLEEN M. O'MALLEY
KATHLEEN M. O'MALLEY
United States District Judge

APPENDIX D

1. 26 U.S.C. 3101 provides in relevant part:

(a) Old-age, survivors, and disability insurance.

In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

In cases of wages received during:	The rate shall be:
1984, 1985, 1986, or 1987	5.7 percent
1988 or 1989	6.06 percent
1990 or thereafter	6.2 percent.

(b) Hospital insurance.

In addition to the tax imposed by the preceding subsection, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

(1) with respect to wages received during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

(2) with respect to wages received during the calendar year 1978, the rate shall be 1.00 percent;

(3) with respect to wages received during the calendar years 1979 and 1980, the rate shall be 1.05 percent;

(4) with respect to wages received during the calendar years 1981 through 1984, the rate shall be 1.30 percent;

(5) with respect to wages received during the calendar year 1985, the rate shall be 1.35 percent; and

(6) with respect to wages received after December 31, 1985, the rate shall be 1.45 percent.

* * * * *

2. 26 U.S.C. 3111 provides in relevant part:

(a) Old-age, survivors, and disability insurance.

In addition to other taxes, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

In cases of wages received during:	The rate shall be:
1984, 1985, 1986, or 1987	5.7 percent
1988 or 1989	6.06 percent
1990 or thereafter	6.2 percent.

(b) Hospital insurance.

In addition to the tax imposed by the preceding subsection, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

(1) with respect to wages paid during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

(2) with respect to wages paid during the calendar year 1978, the rate shall be 1.00 percent;

(3) with respect to wages paid during the calendar years 1979 and 1980, the rate shall be 1.05 percent;

(4) with respect to wages paid during the calendar years 1981 through 1984, the rate shall be 1.30 percent;

(5) with respect to wages paid during the calendar year 1985, the rate shall be 1.35 percent; and

(6) with respect to wages paid after December 31, 1985, the rate shall be 1.45 percent.

* * * * *

3. 26 U.S.C. 3121 provides in relevant part:

(a) Wages.

For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) in the case of the taxes imposed by sections 3101(a) and 3111(a) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) with respect to employment has been paid to an individual by an employer during the calendar year with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration

referred to in the succeeding paragraphs of this subsection) with respect to employment equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

* * * * *

4. 26 U.S.C. 3301 (1994 & Supp. IV 1998) provides:

There is hereby imposed on every employer (as defined in section 3306(a)) for each calendar year an excise tax, with respect to having individuals in his employ, equal to—

(1) 6.2 percent in the case of calendar years 1988 through 2007; or

(2) 6.0 percent in the case of calendar year 2008 and each calendar year thereafter;

of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)).

5. 26 U.S.C. 3306 provides in relevant part:

* * * * *

(b) Wages.

For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year, is paid to such individual by such employer during such calendar year.

* * * * *

6. 26 C.F.R. 31.3101-2 provides in relevant part:

* * * * *

(c) *Computation of employee tax.* The employee tax is computed by applying to the wages received by the employee the rate in effect at the time such wages are received.

Example. In 1972, employee A performed for employer X services which constituted employment (see § 31.3121(b)-2). In 1973 A receives from X $1,000 as remuneration for such services. The tax is payable at the 5.85 percent rate (4.85 percent plus 1.0 percent) in effect for the calendar year 1973 (the year in which the wages are received) and not at the 5.2 percent rate which was in effect for the calendar year 1972 (the year in which the services were performed).

7. 26 C.F.R. 31.3101-3 provides:

The employee tax attaches at the time that the wages are received by the employee. For provisions relating to the time of such receipt, see § 31.3121(a)-2.

8. 26 C.F.R. 31.3111-2 provides in relevant part:

* * * * *

(c) *Computation of employer tax.* The employer tax is computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid.

9. 26 C.F.R. 31.3111-3 provides:

The employer tax attaches at the time that the wages are paid by the employer. For provisions relating to the time of such payment, see § 31.3121(a)-2.

10. 26 C.F.R. 31.3121(a)-2 provides in relevant part:

* * * * *

(a) In general, wages are received by an employee at the time that they are paid by the employer to the employee. Wages are paid by an employer at the time that they are actually or constructively paid unless under paragraph (c) of this section they are deemed to be subsequently paid. For provisions relating to the time when tips received by an employee are deemed paid to the employee, see § 31.3121(q)-1.

(b) Wages are constructively paid when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at anytime although not then actually reduced to possession. To constitute payment in such a case the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that they may be drawn upon at any time, and their payment brought within his own control and disposition. For provisions relating to the treatment of deductions from remuneration as payments of remuneration, see § 31.3123-1.

* * * * *

11. 26 C.F.R. 31.3121(a)(1)-1(a)(2) provides:

> The annual wage limitation applies only if the remuneration received during any 1 calendar year by an employee from the same employer for employment performed after 1936 exceeds the amount of such limitation. The limitation in such case relates to the amount of remuneration received during any 1 calendar year for employment after 1936 and not to the amount of remuneration for employment performed in any 1 calendar year.

* * * * *

12. 26 C.F.R. 31.3301-2 provides:

> The tax for any calendar year is measured by the amount of wages paid by the employer during such year with respect to employment after December 31, 1938. (See §31.3306(b)-1, relating to wages, and §§31.3306(c)-1 to 31.3306(c)-3, inclusive, relating to employment.)

13. 26 C.F.R. 31.3306(b)(1)-1 provides in relevant part:

> (a) *In general.* (1) the term "wages" does not include that part of the remuneration paid within any calendar year by an employer to an employee which exceeds the first $3,000 of remuneration (exclusive of remuneration excepted from wages in accordance with paragraph (j) of §31.3306(b)-1 or §§31.3306(b)(2)-1 to 31.3306(b)(8)-1, inclusive), paid within such calendar year by such employer to such employee for employment performed for him at any time after 1938.
>
> (2) The $3,000 limitation applies only if the remuneration paid during any one calendar year by an

> employer to the same employee for employment performed after 1938 exceeds $3,000. The limitation in such case relates to the amount of remuneration paid during any one calendar year for employment after 1938 and not to the amount of remuneration for employment performed in any one calendar year.
>
> *Example.* Employer B, in 1955, pays employee A $2,500 on account of $3,000 due him for employment performed in 1955. In 1956 employer B pays employee A the balance of $500 due him for employment performed in the prior year (1955), and thereafter in 1956 also pays A $3,000 for employment performed in 1956. The $2,500 paid in 1955 is subject to tax in 1955. The balance of $500 paid in 1956 for employment during 1955 is subject to tax in 1956, as is also the first $2,500 paid of the $3,000 for employment during 1956 (this $500 for 1955 employment added to the first $2,500 paid for 1956 employment constitutes the maximum wages subject to the tax which could be paid in 1956 by B to A). The final $500 paid by B to A in 1956 is not included as wages and is not subject to the tax.

* * * * *

SEP - 7 2000
CLERK

No. 00-203

IN THE

Supreme Court of the United States

UNITED STATES OF AMERICA,
Petitioner,

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

CLEVELAND INDIANS BASEBALL COMPANY'S OPPOSITION TO PETITION FOR CERTIORARI

ROBERT A. DUPUY
JAMES L. HUSTON
ANNE BERLEMAN KEARNEY*
FOLEY & LARDNER
777 E. Wisconsin Avenue
Milwaukee, Wisconsin 53202
414-297-5555

Counsel for Respondent, Cleveland Indians Baseball Company

* *Counsel of Record*

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

STATEMENT REQUIRED BY RULE 29.6

The Cleveland Indians Baseball Company is a limited partnership and does not have a parent company.

TABLE OF CONTENTS

	Page
STATEMENT REQUIRED BY RULE 29.6	i
TABLE OF AUTHORITIES	iv
REASONS FOR DENYING THE WRIT	1
I. THERE IS NO CONFLICT AMONG THE COURTS OF APPEALS.	2
II. THIS CASE DOES NOT MERIT REVIEW.	8
A. The Question Presented Has Not Been Litigated Frequently.	8
B. *Bowman* Was Correctly Decided.	9
1. The Government conflates back pay with year-end pay, with unfair results.	10
a. Congress did not intend to penalize recipients of back pay	11
b. The Government recognizes the concept of back pay	13
c. This Court and *Bowman* require an allocation of back pay.	14
d. Congress did not overrule *Nierotko* in 1946.	15
2. The Government is unpersuasive in urging that the *Bowman* rule would burden taxpayers.	16
3. IRS regulations do not prove *Bowman* wrong.	17
CONCLUSION	18

TABLE OF AUTHORITIES

CASES

	Page
Bowman v. United States, 824 F.2d 528 (6th Cir. 1987)	*passim*
Flemming v. Nestor, 363 U.S. 603 (1960)	10-11
In re Freedomland, Inc., 480 F.2d 184 (2d Cir. 1973), *aff'd sub nom. Otte v. United States*, 419 U.S. 43 (1974)	4
Hemelt v. United States, 122 F.3d 204 (4th Cir. 1997)	3, 4, 8
Johnston v. Harris County Flood Control District, 869 F.2d 1565 (5th Cir. 1989), *cert. denied*, 493 U.S. 1019 (1990)	2-3
Mazur v. Commissioner, 986 F. Supp. 752 (W.D.N.Y. 1997)	7, 8, 12
McCray v. New York, 461 U.S. 961 (1983)	7, 18
San Francisco Baseball Associates L.P. v. United States, 88 F. Supp. 2d 1087 (N.D. Cal. 2000)	7, 12
Social Security Board v. Nierotko, 327 U.S. 358 (1946)	*passim*
United States v. Calamaro, 354 U.S. 351 (1957)	17
United States v. Cartwright, 411 U.S. 546 (1973)	17
Walker v. United States, 202 F.3d 1290 (10th Cir. 2000)	4-7

STATUTES

Self-Employment Contributions Act, 26 U.S.C. §§ 1401-1403	4-5
Federal Insurance Contribution Act, 26 U.S.C. §§ 3101-3128	*passim*
26 U.S.C. § 3101	11, 14
26 U.S.C. § 3101(a)	11

TABLE OF AUTHORITIES—Continued

	Page
26 U.S.C. § 3101(b)	11
26 U.S.C. § 3111	11, 14
26 U.S.C. § 3111(a)	11
26 U.S.C. § 3111(b)	11
26 U.S.C. § 3121	4
26 U.S.C. § 3121(a)(1)	11
26 U.S.C. § 3121(v)(1)	16
26 U.S.C. § 3121(v)(2)	12, 17
Federal Unemployment Tax Act, 26 U.S.C. §§ 3301-3311	*passim*
26 U.S.C. § 3306	4
Employment Retirement Income Security Act of 1974, 29 U.S.C. § 1132	3
42 U.S.C. § 1983	3
42 U.S.C. § 2000e-5	3

REGULATIONS

Treasury Regulation § 1.1402(a)-1(c)	5
Treasury Regulation § 31.3101-2(c), Example	17
Treasury Regulation § 31.3111-2(c)	5
Treasury Regulation § 31.3121(a)(1)-1(a)(2), Example	17
Treasury Regulation § 31.3306(b)(1)-1(a)(2), Example	17

MISCELLANEOUS

H.R. Conf. Rep. No. 2271 (1950), *reprinted in* 1950 U.S.C.C.A.N. 3287	6
H.R. Rep. No. 76-728, reprinted in 1939-2 C.B. 538	11-12
Reporting Back Pay And Special Wage Payments To The Social Security Administration, Pub. No. 957 (Sept. 1997)	13, 16

TABLE OF AUTHORITIES—Continued

Page

1983 Program Policy Statement, SSR 83-7, 1983 WL 31239 ..... 13, 14, 15, 16
S. Rep. No. 1669 (1950), *reprinted in* 1950 U.S.C.C.A.N. 3287 6
Social Security Act Amendments of 1939, ch. 666, §§ 601, 604, 53 Stat. 1360 15-16
Sup. Ct. R. 10 ..... 8, 9

IN THE

Supreme Court of the United States

No. 00-203

UNITED STATES OF AMERICA,
Petitioner,

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

CLEVELAND INDIANS BASEBALL COMPANY'S OPPOSITION TO PETITION FOR CERTIORARI

REASONS FOR DENYING THE WRIT

The Government's petition for certiorari should be denied because there is no genuine conflict among the circuit courts of appeals and because the question presented does not merit the Court's attention. The Government devotes most of its petition to the contention that the Sixth Circuit made the wrong decision in *Bowman v. United States*, 824 F.2d 528 (6th Cir. 1987). We show below in Part II that the Government is mistaken, and that

Bowman has the right answer to the question presented. But first we show that there is no well-developed conflict among the courts of appeals.

I. THERE IS NO CONFLICT AMONG THE COURTS OF APPEALS.

At best, this petition is premature. There is no direct conflict among the circuit courts of appeals, and they may never reach conflicting conclusions as to the question presented. The Government exaggerates when it contends otherwise.

The question presented is exactly the question decided thirteen years ago in *Bowman*. There the Sixth Circuit held that awards of back pay should be allocated for payroll tax purposes to the years when the wage-earners earned the wages they were wrongfully deprived of. *See* 824 F.2d at 530. The court below followed *Bowman* as a controlling authority in this case, holding that back pay awards given to former Cleveland Indians players should be taxed under the Federal Insurance Contribution Act, 26 U.S.C §§ 3101-3128 ("FICA"), and the Federal Unemployment Tax Act, 26 U.S.C. §§ 3301-3311 ("FUTA"), according to the years the players actually earned these wages.

No court of appeals disagrees. In fact, this case and *Bowman* are the only court of appeals' decisions to address the question presented in a deliberate and considered way. Recognizing there is no real conflict, the Government writes nothing at all about other circuit court decisions until the eighteenth page of its petition. Then it tries to make a conflict out of cases that posed different questions or that dealt with this question in an off-handed, conclusory way.

One court of appeals has adopted the *Bowman* rule, but without discussion. In *Johnston v. Harris County Flood Control District*, 869 F.2d 1565, 1579 (5th Cir. 1989), *cert. denied*, 493 U.S. 1019 (1990), the Fifth Circuit remanded its case so damages could be correctly calculated. In that context, it instructed

the trial court to determine whether the award was non-taxable damages under 42 U.S.C. § 1983 or a taxable award of back pay under Title VII, 42 U.S.C. § 2000e-5, *et seq*. *See id*. The court held that Title VII awards are taxable, citing *Bowman* for the rule that, at least for FICA purposes, "a plaintiff receiving a back pay award is liable for the taxes that would have accrued in the year the wages were due." *Id*. at 1580. The *Johnston* court did not otherwise discuss the point.

The point is similarly undeveloped, but with the opposite result, in *Hemelt v. United States*, 122 F.3d 204 (4th Cir. 1997), one of the cases that the Government uses to make a supposed conflict with *Bowman*. That is a long stretch, for *Hemelt* does not even cite *Bowman*. *Hemelt* arose after plaintiffs, former employees of Continental Can Company (and some 5,000 other class members), received settlement awards for their employer's violations of the Employment Retirement Income Security Act of 1974, 29 U.S.C. § 1132, *et seq*. ("ERISA"). *See id*. at 206. Plaintiffs contended their awards were not taxable as income and, even if taxable, were not "wages" for FICA purposes. *See id*. at 207-09. Neither of those issues arose in *Bowman* and neither arises here.

The *Hemelt* panel held that the awards were taxable income and, thus, wages for purposes of FICA. *See id*. at 209. *Hemelt* took up the question presented here only in the last paragraph of its decision, and then with little discussion. *See id*. at 210-11. Its legal analysis was perfunctory, based entirely on a Treasury regulation. *See id*. The panel cited no case law. *See id*. It did not even cite the Internal Revenue Code. *See id*. *Hemelt* gave equal weight to a second rationale that was entirely pragmatic: the total absence of any evidence from which the awards could have been allocated to the class members' years of service. *See id*. Thus, if such conclusory treatment can be called a conflict at all, it is between *Bowman* and the need for a practical solution to a class action problem or between *Bowman* and the Treasury Regulation. It is not a conflict between *Bowman* and *Hemelt*.

The Government stretches even further when it imagines a conflict between *Bowman* and the decisions in *In re Freedomland, Inc.*, 480 F.2d 184 (2d Cir. 1973), *aff'd sub nom. Otte v. United States*, 419 U.S. 43 (1974). *See* Pet. 20. The Government concedes that neither the Second Circuit in *Freedomland* nor this Court dealt "with the precise question presented in this case." Pet. 21-22. That is an understatement. Indeed, the supposed conflict with *Bowman* is no more than dictum, uttered without consideration for the issues that *Bowman* discussed and resolved.

The Court granted certiorari in *Otte* "primarily because the circuits are in disarray as to the priority to be accorded to withholding taxes on prebankruptcy wage claims." 419 U.S. at 47. The *Freedomland* and *Otte* dicta that the Government relies on dealt with *when* liability for payroll taxes arises. That answer, as *Freedomland* put it, "is too firmly embedded in the income tax law to permit of any question." *See Freedomland*, 480 F.2d at 189 n.8; *Otte*, 419 U.S. at 55. Nor is it disputed here; liability for these payroll taxes arose in 1994, when the former players received their awards. But that is not the question presented, which is whether the payroll taxes due in 1994 should have been calculated according to the rates and ceilings then in effect, or according to the rates and ceilings effective in 1986 and 1987 when the players earned the wages they did not receive until 1994.[1]

Just as *Hemelt* and *Freedomland/Otte* do not create a conflict with *Bowman*, neither does *Walker v. United States*, 202 F.3d 1290 (10th Cir. 2000). The *Walker* court considered the Self-Employment Contributions Act, 26 U.S.C. §§ 1401-1403

[1] The Cleveland Indians and the Government stipulated *for this case only* that these 1994 awards were "wages," as the term is defined for payroll tax purposes in 26 U.S.C. § 3121 and 26 U.S.C. § 3306. However, this wages issue is being litigated by other Major League Baseball Clubs in the cases that the Government lists in its petition. *See* Pet. 23.

("SECA"), and its corresponding regulations. *Walker* creates no conflict with *Bowman* because SECA is governed by different statutes and regulations than the FICA statutes and regulations at issue here and in *Bowman*.

The *Walker* court held that the self-employed attorney plaintiff had to pay SECA taxes calculated as of the years when he received the contingency fees at issue. The Tenth Circuit panel based its holding on Treasury Regulation § 1.1402(a)-1(c), which contains dispositive language that has no parallel in the regulations governing FICA. *See* 202 F.3d at 1291-93. The SECA regulation states as follows (with our emphasis on the clause that has no counterpart in the FICA regulation, Treasury Regulation § 31.3111-2(c)):

> Gross income derived by an individual from a trade or business includes gross income received (in the case of an individual reporting income on the cash receipts and disbursements method) or accrued (in the case of an individual reporting income on the accrual method) in the taxable year from a trade or business *even though such income may be attributable in whole or in part to services rendered or other acts performed in a prior taxable year as to which the individual was not subject to the tax on self-employment income.*

Treasury Regulation § 1.1402(a)-1(c).

By contrast, the corresponding FICA regulation, Treasury Regulation 31.3111-2(c), states only that "[t]he employer tax is computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid." Presumably the Treasury would at least have added the italicized language to its FICA regulation if it had intended to treat "wages" the same way it treats self-employment income. Given *Walker*'s reliance on a SECA regulation that differs materially from the FICA regulation, the court's decision in *Walker* does not conflict with *Bowman*.

Further, the inherent differences in the Internal Revenue Code's treatment of SECA and FICA also evidence why there is no conflict with *Bowman*. The *Walker* court relied on the symmetry between the SECA tax and the income tax. *See* 202 F.3d at 1293 ("just as income is taxable when received for cash-basis taxpayers, so too self-employment income is subject to SECA taxes when received"). That symmetry is found in the Internal Revenue Code, which has the SECA tax in Subtitle A, entitled "Income Tax." But there is no parallel symmetry between the FICA tax and income taxes. FICA provisions are found in Subtitle C, entitled "Employment Taxes."

The legislative history shows that the difference in location was intentional and significant. The House bill imposing the SECA tax included the SECA provisions in the employment tax section of the Code. *See* H.R. Conf. Rep. No. 2271 (1950), *reprinted in* 1950 U.S.C.C.A.N. 3287, 3502. However, the House-Senate conference moved the SECA provisions to Subtitle A, the income tax section. *See id.* at 3502-03. The Conference Report explained that it did so because, "[in] view of the close connection between the self-employment tax and the present income tax, and in the interest of simplicity for taxpayers and economy in administration, . . . it is preferable to have the tax on self-employment income handled in all particulars as an integral part of the income tax." *Id.*

However, the same conference declined to adopt a Senate amendment that would also have combined the withholding of income tax and the FICA tax. *See id.* at 3506. That change would have simplified reporting for employers, who would have deducted a single sum for income taxes and FICA taxes combined. *See* S. Rep. No. 1669 (1950), *reprinted in* 1950 U.S.C.C.A.N. 3287, 3444-45. Thus, while Congress considered SECA tax and income tax sufficiently similar that they should be included in the same subtitle of the Code, Congress considered FICA tax and income tax to be too dissimilar to be positioned together in the Code or to be combined on employer returns. Because *Walker* dealt with a point of SECA taxation that is only superficially similar to the FICA tax at issue in *Bowman*, the two cases do not conflict.

In the end, the Government is left with only one case that squarely addresses this tax allocation issue and conflicts with *Bowman*. That is *Mazur v. Commissioner*, 986 F. Supp. 752 (W.D.N.Y. 1997), which deliberately rejected *Bowman* in favor of a Treasury Regulation that was in place when *Bowman* was decided. *See id.* at 755. But *Mazur* is a trial court decision. It does not present the sort of conflict that might merit the Court's review. The Government's petition is like the petition in *McCray v. New York*, 461 U.S. 961, 962-63 (1983) (Stevens, J., respecting denial of certiorari), where it was better to give lower courts more time to develop the issue.

The Government is appropriately underwhelmed by its showing of a conflict, and tries to bulk up its position by pointing to other refund suits brought by other Major League Baseball Clubs that present the same question. *See* Pet. 23. But those cases do not conflict with *Bowman* at all. So far only one of these baseball cases has gone to decision, and it followed *Bowman*. In *San Francisco Baseball Associates L.P. v. United States*, 88 F. Supp. 2d 1087 (N.D. Cal. 2000), Judge Conti independently assessed the FICA and FUTA allocation issue and was persuaded by *Bowman*:

> This Court finds the reasoning of the *Bowman* Court persuasive. In particular, this Court agrees that the clarity, symmetry, and fairness of the Social Security system is advanced by using the same allocation principle for both benefits and taxation.

Id. at 1094-95 (citing *Bowman*, 824 F.2d at 530).

The Government has appealed the decision in *San Francisco Baseball Associates* to the Court of Appeals for the Ninth Circuit. If the Ninth Circuit affirms, there will be no conflict with *Bowman* and no question deserving of this Court's attention.

Even if the Ninth Circuit decides to disagree with *Bowman*, other baseball cases pending in other circuits have the potential to build a better-developed body of circuit-court law, based on similar facts, which the Court could later evaluate in exercising its discretionary jurisdiction. But then is not now, and certiorari if and when there is a conflict will be soon enough.

II. THIS CASE DOES NOT MERIT REVIEW.

The Court typically exercises its discretionary jurisdiction only to decide the most important federal questions. *See* Sup. Ct. R. 10. The question presented is not important enough for the Court's review now, not even if there were a conflict among the circuits.

A. The Question Presented Has Not Been Litigated Frequently.

Contrary to the Government's rhetoric, the question presented has not been a frequently recurring issue. The Government represents that the law for taxing back pay has gone unchanged since 1946. *See* Pet. 11-12 & n.7. In the 54 years since then, this question of allocating back pay for FICA and FUTA purposes has spawned taxpayer litigation only four times: in *Bowman*, in *Hemelt*, in *Mazur*, and in these baseball cases each of which arises out of payments made under one discrete settlement signed in 1990. Thus, the Government exaggerates again in its petition when it writes that this issue "is likely to generate controversy and result in litigation." Pet. 22. The Government parades hundreds of thousands of back pay cases as if they were horribles destined to bury the courts in *Bowman*-like litigation. But litigation that averages once every thirteen years should not be called "likely." Especially where there is no real conflict among the circuits, this case is just not worth the Court's consideration on grounds of importance or frequency of occurrence.

Indeed, the Government did not seek certiorari in *Bowman* itself, thirteen years ago. If *Bowman* were truly the catastrophe

the Government now suggests it is, one would have expected the Government to have sought this Court's review then. Furthermore, the Government admits that it does not even follow *Bowman* in its administration of the tax laws. *See* Pet. 22. Thus, *Bowman* has not created administrative difficulties for the Government, nor has it spawned a flood of litigation.

B. *Bowman* Was Correctly Decided.

Although the Government devotes most of its petition to arguing that *Bowman* was wrongly decided, no manifest legal error compels the Court's attention. *Cf.* Sup. Ct. R. 10. In the end, the Government is wrong. *Bowman* got it right. *Bowman* keeps the Government from punishing these players for being the victims of the Clubs' collusion. The *Bowman* rule was intended to, and does, "advance the clarity, symmetry and fairness of the system." 824 F.2d at 530.

Bowman involved an employee who had settled a race discrimination lawsuit against his employer, Ford Motor Company ("Ford"), which had agreed to pay him back wages. *See id.* at 528-29. After Ford withheld FICA taxes on the maximum amount applicable to the year in which Ford paid the settlement money, Mr. Bowman filed a refund suit, contending *inter alia* that "FICA taxation of the settlement wages was improper because those wages represented back wages for years in which Mr. Bowman had paid maximum FICA taxes." *Id.* at 528-29.

The issue in *Bowman* is the same as the issue here: "whether the back pay should be taxable in the year the award is received . . . or in the year or years to which the back pay relates." *Id.* at 529. In answering this question, the Sixth Circuit relied on the Court's decision in *Social Security Board v. Nierotko*, 327 U.S. 358 (1946). *See Bowman*, 824 F.2d at 529-30. *Nierotko* involved an employee who was awarded back pay after the National Labor Relations Board determined he had been wrongfully discharged by his employer (coincidentally, also Ford) for his union activity. *See* 327 U.S. at 359. A unanimous Court

concluded that the award of back pay constituted wages for purposes of determining social security benefits and should be "allocated to the periods when the regular wages were not paid as usual." *Id.* at 370. Applying the Supreme Court's reasoning, the *Bowman* court concluded:

> If the payments are in fact for prior years and if, under *Nierotko*, they should be attributable to prior years for purposes of eligibility and other incidents of Social Security benefits and administration, we can see no reason for not applying this same principle in allocating the incidents of taxation. Where there is no good reason not to apply the same principle, we advance the clarity, symmetry and fairness of the system by using the same principle of allocation.

824 F.2d at 530.

The Government opens its argument for certiorari by contending that *Bowman* was wrongly decided. *See* Pet. 8-18. We show now that the Government is mistaken.

1. The Government conflates back pay with year-end pay, with unfair results.

If the Government's position were correct, employees who have been deprived of wages would also be punished for being victims. That is, the Government would make wronged employees who receive back pay awards pay a FICA tax that they would not have had to pay if they had not been wronged. Even so, because *Nierotko* holds that social security benefits associated with back pay are attributed to the years the employees performed services, they get no corresponding increase in social security benefits from the Government's piling-on. That result, which the Government advocates here, would be patently unfair. It is an unfairness forbidden by the Supreme Court's decision in *Nierotko* and by *Bowman*.

In its petition, the Government cites *Flemming v. Nestor*, 363 U.S. 603, 609 (1960), for the proposition that Congress has the

power to disconnect benefits from the payment of taxes. *See* Pet. 17. That is certainly true. *Flemming* held that it was not unconstitutional for Congress to terminate social security payments for an alien deported for having once belonged to the Communist Party. *See* 363 U.S. at 611-612, 621. But *Flemming* is irrelevant; the Cleveland Indians do not contend that the Government's position is unconstitutional, only that the Government wants to impose an unfairness *that Congress did not intend*.

a. Congress did not intend to penalize recipients of back pay.

The Government errs where it contends that *Bowman* misread the plain meaning of the statute. *See* Pet. 8-9. But *Bowman* got it right. Those code sections—26 U.S.C. §§ 3101(a),(b); 3111(a),(b); and 3121(a)(1)—govern the taxation of year-end pay, not back pay. Convenience and other compelling administrative reasons explain why, for example, wages paid in January for services performed in the previous year or month should be taxed in the year paid. That was Congress' focus in 1939 when it gave the relevant parts of 26 U.S.C. §§ 3101 and 3111 their present form. The earlier versions had tied payroll taxes to the years when services were performed. The House Ways and Means Committee explained the change solely in terms of the widespread confusion that would otherwise accompany the taxation of year-end pay, thus:

> [The earlier formulation] will unnecessarily complicate the making of returns and the collection of the taxes in later years when the rate of tax has been increased. For example, in 1943 the rate of tax increases from 1 per cent to 2 per cent. Thus, wages which are paid in 1943 for services performed in 1942 will be subject to the 1 per cent rate, while wages paid in 1943 for services performed in that year will be subject to the 2 per cent rate. . . . If employers have failed to make the proper distinction, many refunds and

> additional assessments will doubtless be necessary and confusion will result.

H.R. Rep. No. 76-728, at 57-58 (1939), *reprinted in* 1939-2 C.B. 538, 546.

Employers routinely pay wages in one year for services rendered in the previous year. Administrative convenience alone justified the 1939 amendments because any inequities would wash out over time. But the *Nierotko-Bowman* rule recognizes (and avoids) the unfairness that would result if these sections were woodenly applied also to back pay received years after the services were performed. Even *Mazur*, which the Government likes for its different result, acknowledges that the statutes are "not clear[]" as to their application to back pay. *See* 986 F. Supp. at 754. *Mazur* adds that the regulations are only "more clear," meaning that not even the Treasury's own hand-crafted texts dispose of the point. *See id.* The *San Francisco Baseball Associates* court agreed: "the Court finds that the statutes do not unambiguously apply to the cases of back-pay awards." 88 F. Supp. 2d at 1095.

Back pay awards are identical in timing to deferred compensation paid by agreement between an employer and employee. Congress does not subject the recipients of deferred compensation to FICA taxation twice. An employee who performs services in a particular year is subject to the FICA taxation ceiling in that year only, even when some of the wages are actually paid in future years under a deferred compensation arrangement. *See* 26 U.S.C. § 3121(v)(2). No FICA taxes are due on those deferred payments in the years when they are actually paid.

The *Nierotko-Bowman* allocation rule is entirely consistent with the policy for deferred compensation, its logical analogue. In each case, the employee is compensated eventually for work performed in an earlier year. *Nierotko-Bowman* requires both cases to be taxed the same way: the employee is subject to the maximum taxable FICA wage base in the year the employee

performed the services, not the year in which payment of a portion of the compensation for such services is delayed, whether by agreement or by employer wrongdoing. It would make no sense for Congress to lay a FICA tax on deferred compensation just once, but to tax back-pay twice. Why would Congress want to penalize employees who had to litigate their back pay awards but impose FICA taxes only once on employees who negotiated deferred compensation?

As *Nierotko* and *Bowman* held, the fair result is to allocate pay to the year in which services were performed. It is illogical to presume that Congress intended to tax similarly-situated recipients of deferred income differently.

b. The Government recognizes the concept of back pay.

Both the IRS and the Social Security Administration ("SSA") recognize that back pay is legally different from lag payments that employers typically make in one year for services performed near the end of the previous year. The SSA acknowledged the difference in its 1983 Program Policy Statement, SSR 83-7, 1983 WL 31239, at *1-2, specifically providing that it must follow *Nierotko* in allocating back pay awards to the year the services were performed. As SSA recognizes, its rules should not "defeat the intent of the [*Nierotko*] decision requiring SSA to credit and allocate a back pay award so as to place the employee in the position he or she would have been but for the wrongful action that was the basis for the award." *Id.* at *2. The IRS also understands that back pay is a creature distinct from year-end pay, as demonstrated by its publication, *Reporting Back Pay And Special Wage Payments to the Social Security Administration*, Pub. No. 957 (Sept. 1997).

The awards to these former players may not be back pay awards as the SSA defines them.[2] But that is immaterial, for these IRS and SSA publications make clear that back pay is a concept legally distinct from the year-end pay governed by 26 U.S.C. §§ 3101 and 3111 and the other statutes that the Government relies on. In fact, there is nothing in those statutes or in their legislative history to suggest that Congress intended to impose a penal FICA tax on persons whose wages were wrongfully delayed for several years.

c. This Court and *Bowman* require an allocation of back pay.

Nierotko requires that, if back pay is to be treated as wages at all, it must be "allocated to the periods when the regular wages were not paid as usual." 327 U.S. at 370. That is, recipients of back pay awards get credit for benefit purposes in the years when they would have received the wages but for the wrongdoing, not in the year when they actually received the payments. Nevertheless, the Government (ignoring *Nierotko*) wants to tax back pay as of the year of payment, a year in which (as *Nierotko* requires) the employees get no benefit credit. This creates an unfairness that *Bowman* refused to countenance, holding instead that the goals of the social security system are best met by the *Nierotko* "allocation principle":

> If the payments are in fact for prior years and if, under *Nierotko*, they should be attributable to prior years for purposes of eligibility and other incidents of Social Security benefits and administration, we can see no reason for not applying this same principle in allocating the incidents of taxation.

824 F.2d at 530.

---

[2] SSA defines back pay to include only awards that flow from "an award, determination, or agreement approved or sanctioned by a court or administrative agency charged with enforcing a Federal or State statute protecting an employee's right to employment or wages." 1983 WL 31239, at *1.

Under the *Nierotko-Bowman* rule, back pay is taxed as it would have been but for the wrongdoing of the employer. For both Social Security benefits and taxation the employee is, and should be, no worse off for having been wronged.

d. Congress did not overrule *Nierotko* in 1946.

The Government argues in its petition that *Bowman* should not have relied on *Nierotko*'s allocation principle because Congress effectively overruled it in 1946 by changing benefit provisions of the Social Security Act. *See* Pet. 15-16. That is plainly wrong because the SSA follows *Nierotko* to this day. The SSA's 1983 Program Policy Statement discussing back pay states that, under *Nierotko*,

> Where the intent of the award is to place the person involved in all respects in the position he or she would have been [in] had there been no wrongful action, the wages, so far as crediting to the earnings record is concerned, are to be treated as though the person actually performed the services.

1983 WL 31239, at *2.

Nierotko insists (and the Government admits when it wears its SSA hat) that victims must not lose social security benefits as a result of their employers' wrongs. *Bowman* establishes a tax symmetry, so that victimized employees do not pay FICA taxes for years that, under *Nierotko*, do not count for benefits purposes. It is an elegant and fair system, one that was not (as the Government contends at page 16 of its petition) destroyed by the 1946 amendments to the Social Security Act.

In fact, the 1946 amendments only tweaked the more fundamental changes in the Social Security Act that Congress had made in 1939. By the 1939 amendments, Congress decided that the rates of FICA taxes would be calculated "with respect to wages paid during the calendar year," not "with respect to em-

ployment during the calendar year" as provided in the original Act. *See* Social Security Act Amendments of 1939, ch. 666, §§ 601, 604, 53 Stat. 1360, 1381-83. In contrast, the 1946 amendments cited here by the Government only brought the annual *ceiling* on taxable wages into line with the changes in FICA *rates* that Congress had adopted for year-end pay in 1939. *Nierotko* took the 1939 amendments into account, *see* 327 U.S. at 360 & n.5, but nevertheless applied the earlier statutes, those in effect when the services were performed. Because the 1946 amendments reflected the same policy choice as the 1939 amendments, the Government errs when it contends at page 15 of its petition that the social security scheme that *Nierotko* construed in 1946 differed significantly from the scheme that *Bowman* construed in 1987. *Bowman* read *Nierotko* perceptively, but the Government gets lost in details of administrative convenience, overlooking the principles of fairness and symmetry that *Nierotko* and *Bowman* taught.

2. The Government is unpersuasive in urging that the *Bowman* rule would burden taxpayers.

Taxpayers are rightly suspicious when the Government claims it wants to ease their administrative burdens. A case in point is the Government's argument in its petition that taxpayers would be unduly burdened if they had to treat back pay specially. *See* Pet. 17-18. In fact, the *Nierotko* rule as implemented by SSA and Treasury regulations already requires employers to identify back pay and report it separately. *See* SSA Program Policy Statement, 1983 WL 31239, at *1; IRS Pub. No. 957, at 2.

Moreover, taxpayers must already cope with other differences between income taxes and payroll taxes. For example, employee contributions to 401(k) plans are tax-deferred for income tax purposes but taxable under FICA in the year the services are performed. *See* 26 U.S.C. § 3121(v)(1). Nonqualified deferred compensation is taxed for FICA purposes in the year the services are performed, but is not subject to income taxes until the compensation is paid. *See* 26 U.S.C. § 3121(v)(2). There is no symmetry with income tax treatment.

In the end, arguments from administrative convenience do not carry much weight on tax issues. The Government lost when it made the same argument in *Nierotko* itself. The Court answered that, "[a]dmittedly there are accounting difficulties [from the Court's holding] which the [Social Security] Board will be called upon to solve but we do not believe they are insuperable." *Nierotko*, 327 U.S. at 370. Neither are the IRS' administrative problems insuperable, as shown, for example, by the existing dissymmetries in the tax treatment of 401(k) contributions and of non-qualified deferred compensation.

3. IRS regulations do not prove *Bowman* wrong.

The Government believes *Bowman* is wrong because it does not conform to Treasury Regulations. *See* Pet. 14-15. The Government cites a host of regulations at pages 12-14 of its petition, but does not mention that the official examples involve the taxation of year-end pay, not back pay. *See* Treasury Regulation § 31.3101-2(c), Example; Treasury Regulation § 31.3121(a)(1)-1(a)(2), Example; Treasury Regulation § 31.3306(b)(1)-1(a)(2), Example. It is not at all clear that the regulations apply to back pay. If they do, it is not clear that the regulations are consistent with the Congressional intent discerned in the legislative history discussed above at pages 11-12.

The concept of deference to agency rules "set[s] the framework for judicial analysis; it does not displace it." *See United States v. Cartwright*, 411 U.S. 546, 550 (1973). An agency may not rewrite, add to or expand a statute beyond what Congress intended. *See United States v. Calamaro*, 354 U.S. 351, 358-59 (1957).

Bowman considered the regulations that the Government relies on here, *see* 824 F.2d at 529, but decided they do not apply

to back pay. As discussed above, Treasury regulations may only supplement the intent of Congress. They may not undermine that intent by bringing back pay awards within the regime that Congress created for year-end pay. *Bowman* correctly declined to treat these regulations with the deference the Government wishes for.

CONCLUSION

There is no deliberate, well-reasoned split between *Bowman* and any other court of appeals' decision that could serve well as a foundation for the Court's harmonizing role. Maybe there will never be a conflict that needs the Court's attention. But if a conflict does develop, further consideration in the Ninth and, perhaps, other circuit courts of appeals is likely to serve the Court well when a definite conflict develops. *Cf. McCray*, 461 U.S. at 962-63. The question presented is not important enough, and does not arise frequently enough, for the Court's attention. Therefore, the Cleveland Indians Baseball Company asks the Court to deny the Government's petition for certiorari.

Respectfully submitted,

ROBERT A. DUPUY
JAMES L. HUSTON
ANNE BERLEMAN KEARNEY*
FOLEY & LARDNER
777 E. Wisconsin Avenue
Milwaukee, Wisconsin 53202
414-297-5555

Counsel for Respondent,
Cleveland Indians Baseball Company

September 7, 2000

* *Counsel of Record*

(3)

No. 00-203

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

SETH P. WAXMAN
Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202)514-2217

TABLE OF AUTHORITIES

Cases:

Algie v. *RCA Global Communications, Inc.*, No. 89 CIV 5471, 1995 WL 606096 (S.D.N.Y. Oct. 12, 1995) 5

Bowman v. *United States*, 824 F.2d 528 (6th Cir. 1987) 1

Cohen v. *United States*, 63 F. Supp. 2d 1131 (C.D. Cal. 1999) 5

Hemelt v. *United States*, 122 F.3d 204 (4th Cir. 1997) 2, 3

Mazur v. *Commissioner*, 986 F. Supp. 752 (W.D. N.Y. 1997) 5

Social Sec. Bd. v. *Nierotko*, 327 U.S. 358 (1946) 3

Tungseth v. *Mutual of Omaha Ins. Co.*, 43 F.3d 406 (8th Cir. 1994) 4

Walker v. *United States*, 202 F.3d 1290 (10th Cir. 2000) 3

Miscellaneous:

K. Gideon, *Lawsuits and Settlements* (1995) 5

In the Supreme Court of the United States

No. 00-203

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

1. Respondent errs in claiming (Br. in Opp. 2-8) that there is no conflict among the circuits on the question presented in this case. Both of the courts below acknowledged that this conflict exists. The district court, which was bound to apply the Sixth Circuit's decision in *Bowman* v. *United States*, 824 F.2d 528 (1987), noted that "at least one court has disagreed with *Bowman* since that decision was issued, instead applying the allocation the government urges here." Pet. App. 10a-11a. The court of appeals was also frank in acknowledging that "cases from our sister circuits * * * are at odds with our *Bowman* holding." *Id.* at 5a. Contrary to respondent's claim, the decision in this case

thus involves an acknowledged circuit conflict on an issue of recurring importance.

Respondent nonetheless attempts to parse these conflicting decisions in an effort to construct distinctions among them. For example, respondent argues that *Hemelt* v. *United States*, 122 F.3d 204 (4th Cir. 1997), does not conflict with the decision in this case for two reasons: (i) because "*Hemelt* does not even cite *Bowman*" and (ii) because, in reaching a decision in *Hemelt* on "the question presented here" that directly conflicts with the result reached in *Bowman*, the analysis of the court in *Hemelt* "was perfunctory" (Br. in Opp. 3). Neither rationale supports the proposition that these two decisions are not in conflict.

As we explain in the petition (Pet. 18-19), although the taxpayers in *Hemelt* expressly relied on *Bowman*, the court of appeals concluded that the reasoning applied in that case was "meritless." 122 F.3d at 210. While the Fourth Circuit in *Hemelt* did not cite *Bowman* in stating that its reasoning was "meritless," these two decisions are squarely in conflict—as both the district court and the court of appeals acknowledged in this case. Pet. App. 5a, 10a. Indeed, respondent has itself grudgingly acknowledged the existence of this conflict. Respondent admits (Br. in Opp. 3) that the court in "*Hemelt* took up the question presented here" and that its decision on that question is inconsistent with the decision reached in *Bowman*.

Respondent nonetheless contends that, in deciding "the question presented here" in a manner that conflicts with *Bowman*, the *Hemelt* court employed "little discussion" and only a "perfunctory" legal analysis. Br. in Opp. 3. Respondent suggests (*ibid.*) that the "conclusory" reasoning of *Hemelt* is insufficient to establish a "conflict" among the circuits.

We of course disagree with respondent's derogatory description of the reasoning applied by the Fourth Circuit in the *Hemelt* decision. That court's conclusion that the FICA tax applies to wages when "received" rather than "to the years to which [wages] are attributable" (122 F.3d at 210) is squarely supported by the clear text and history of the statute and its implementing regulations. See also Pet. 8-18. It is, in any event, evident (as respondent concedes) that the *Hemelt* court in fact *did* rule upon "the question presented here" and, in doing so, *did* reach a result that conflicts precisely with the decision in *Bowman* (and therefore with the decision in the present case). As a published decision, *Hemelt* is no less binding precedent in the Fourth Circuit than *Bowman* is in the Sixth Circuit.[1]

---

[1] Respondent also argues (Br. in Opp. 5) that *Walker* v. *United States*, 202 F.3d 1290 (10th Cir. 2000), does not conflict with the decision in this case because *Walker* involved the *self*-employment taxes imposed under Subtitle A of the Internal Revenue Code instead of the FICA employment taxes imposed under Subtitle C of the Code. Although respondent suggests that this means the underlying statutory issues are only "superficially similar" (Br. in Opp. 7), there is in fact no analytical difference: the self-employment tax is imposed on income from self-employment; the FICA tax is imposed on income from employment by others. In holding that the self-employment tax applies to wages at the time they are paid, rather than at the time when the services for which the compensation is made were performed, the court in *Walker* expressly rejected the contrary conclusion of the Sixth Circuit in *Bowman* as "unpersuasive." 202 F.3d at 1293. The court in Walker also concluded, in agreement with our position (and contrary to respondent's), that the decision in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), is "inapposite" to the issue in this case. Compare Pet. 14-16 with Br. in Opp. 9-10.

Even in situations in which courts do not write extensively to set forth their reasoning, if they have reached differing conclusions on the same question of law, the result is that litigants will be subject to different rules in different circuits. For example, due to the conflicting decisions on the question presented in this case, taxpayers in some circuits will pay different amounts of taxes than will be paid by similarly situated taxpayers elsewhere. It is precisely that sort of conflict among the circuits that frustrates the uniform application of national rules of law and therefore warrants resolution by this Court.

2. Respondent is wrong in asserting (Br. in Opp. 8-9) that the question presented in this case lacks recurring importance. As we describe in the petition, the settlement agreement involved in this case has already led to litigation in nine separate suits filed in four separate circuits (First, Third, Eighth and Ninth). See Pet. 23. An additional 17 suits stemming from this settlement may yet be filed in additional circuits. See *ibid.*

The question presented here arises routinely whenever taxpayers receive (or pay) back wage awards. See Pet. 22. Of course, the amount of back wages awarded to the baseball players involved in this litigation exceeds the amount ordinarily at issue in such cases. The taxpayer's incentive to litigate the issue is accordingly greater here than is ordinarily the case. Nonetheless, as respondent acknowledges (Br. in Opp. 8), this same issue has been litigated in the past in several reported (and unreported) cases. See also *Tungseth* v. *Mutual of Omaha Ins. Co.*, 43 F.3d 406, 409 (8th Cir. 1994) (noting that "there is a split of authority whether back wages are subject to FICA taxation in the years to which the back pay relates or in the year in which the award is

received"); *Cohen* v. *United States*, 63 F. Supp. 2d 1131, 1135 (C.D. Cal. 1999) (declining to apply *Bowman* and concluding that severance payments were taxable when paid, not when earned); *Mazur* v. *Commissioner*, 986 F. Supp. 752, 754 (W.D.N.Y. 1997) (expressly rejecting *Bowman* and holding that FICA applies to wages when received rather than when earned); *Algie* v. *RCA Global Communications, Inc.*, No. 89 CIV 5471, 1995 WL 606096 (S.D.N.Y. Oct. 12, 1995). Moreover, the frequency of such disputes is likely to be enhanced by the decision in the present case.

3. Respondent devotes the largest portion of its brief to an effort to defend the *Bowman* decision on the merits. The contentions aired in respondent's brief are incorrect for the reasons we have explained in the petition. See Pet. 8-18. Respondent's contentions are, moreover, precisely the same as those rejected by the courts of appeals in the *Hemelt* and *Walker* cases. In short, respondent's claim that "*Bowman* got it right" (Br. in Opp. 9) is wrong.[2] Until this Court addresses and resolves the conflict that exists among the circuits on the question presented in this case, however, the "*Bowman* rule" (*ibid.*) will continue to apply in the

---

[2] Respondent fails to address the statutory text, legislative history and regulations that govern the question presented in this case. See Pet. 8-18. Instead, respondent relies upon general, unfounded contentions such as the notion that the government's position has the effect of "punish[ing]" employees "for being victims." Br. in Opp. 10. Of course, the government's position seeks to punish no one. The government seeks only to enforce the statute in the manner that Congress has directed. Moreover, as we point out in the petition, the position advocated by respondent would often cause taxpayers to pay *more* taxes. Pet. 17-18. Not only is "*Bowman* * * * expensive for most taxpayers, it also imposes substantial administrative burdens on the IRS." K. Gideon, *Lawsuits and Settlements* § 1101.4, at 263 n.42 (1995).

Sixth Circuit and taxpayers will continue to be treated differently based solely upon the geographical happenstance of the circuit in which they reside. For the reasons stated here and in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General

SEPTEMBER 2000

Supreme Court, U.S.
FILED
NOV 29 2000
CLERK

(5)

No. 00-203

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

JOINT APPENDIX

ANNE BERLEMAN KEARNEY
Foley & Lardner
777 E. Wisconsin Avenue
Milwaukee, Wis. 53202
(414) 297-5555

Counsel of Record
for Respondent

SETH P. WAXMAN
Solicitor General
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

Counsel of Record
for Petitioner

PETITION FOR WRIT OF CERTIORARI FILED: AUGUST 8, 2000
CERTIORARI GRANTED: OCTOBER 16, 2000

HHP

TABLE OF CONTENTS

	Page
Relevant docket entries, United States District Court for the Northern District of District of Ohio (Cleveland)	1
Relevant docket entries, United States Court of Appeals for the Sixth Circuit	14
Stipulated Facts	21
Statutory Provisions	30

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF OHIO (CLEVELAND)

Civil Docket for Case No. 96-CV-2240

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP ORGANIZED IN THE
STATE OF OHIO, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

DOCKET ENTRIES

DATE	DOCKET NUMBER	PROCEEDINGS
10/15/96	–	FILING FEE: on 10/15/96 in the amount of $120.00, receipt #241029. (baw) [Entry date 10/16/96]
10/15/96	–	ASSIGNMENT OF MAGISTRATE JUDGE pursuant to Local Rule 1:2.4, Assignment of Cases. In the event of referral this case will be referred to Mag. Judge Jack B. Streepy. 1 pg (dh) [Entry date 10/21/96]

DATE	DOCKET NUMBER	PROCEEDINGS
10/15/96	1	COMPLAINT (Service: summons issd, magistrate consent form issd) (exh & 12 pgs) (dh) [Entry date 10/21/96]
10/15/96	2	CIS filed by pltf. Recommended Track: Standard. (2 pgs) (dh) [Entry date 10/21/96]
10/16/96	3	PRAECIPE by pltf for issuance of alias summons. (issued on 10/16/96) (1 pg) (dh) [Entry date 10/21/96]
10/18/96	4	MOTION by pltfs for attys Robert A. Dupuy, Timothy C. Frautschi & Mary Kay Braza to appear pro hac vice (4 pgs) (dh) [Entry date 10/22/96]
10/30/96	–	MARGINAL ENTRY ORDER granting motion by pltfs for attys Robert A Dupuy, Timothy C. Frautschi & Mary Kay Braza to appear pro hac vice [4-1] (issued on 10/30/96) Judge Kathleen M. O'Malley (dh) [Entry date 10/31/96]

DATE	DOCKET NUMBER	PROCEEDINGS
11/25/96	5	ATTORNEY APPEARANCE on behalf of deft by attys Stephen A. Sherman, & Annette G. Butler (2pgs) (dh) [Entry date 11/26/96]
12/18/96	6	MOTION by deft for ext of time until 1/17/97 to answer pltf's complt w/memo in supp. (3 pgs) (dh) [Entry date 12/19/96]
1/10/97	–	MARGINAL ENTRY ORDER granting motion by deft for ext of time until 1/17/97 to answer pltf's complt [6-1] (issued on 1/13/97) Judge Kathleen M. O'Malley (dh) [Entry date 01/13/97]
1/21/97	7	ANSWER to Complaint by USA (6pgs) (dh) [Entry date 01/23/97]

DATE	DOCKET NUMBER	PROCEEDINGS
2/12/97	8	CASE MANAGEMENT CONFERENCE scheduling order. CMC set at 12:30 p.m. on 3/6/97 in room 135 before Judge O'Malley (issued on 2/12/97) (3 pgs) Judge Kathleen M. O'Malley (dh) [Entry date 02/14/97]
2/25/97	9	MAIL Returned addressed to plaintiff Cleve Indians Co re: CMC scheduling order (rs) [Entry date 02/26/97]
3/4/97	10	STATEMENT by deft USA re the CMC (4 pgs) (dh) [Entry date 03/05/97]
3/6/97	11	CASE MANAGEMENT PLAN/ ORDER: Track Designation: standard, CMC held on 3/6/97; non-expert discovery to be complete by 12/6/97; expert discovery to be complete by 12/24/97; expert rpts shall be exchanged by 9/1/97 for initial & 11/1/97 for rebuttal; disp mtn filing ddl is 2/1/98; status hrg set at 12:30 p.m. on

DATE	DOCKET NUMBER	PROCEEDINGS
		7/31/97 (issued on 3/6/97) (4 pgs) Judge Kathleen M. O'Malley (dh) [Entry date 03/07/97]
7/31/97	12	STATUS Report by deft (3 pgs) (js) [Entry date 08/01/97]
7/31/97	13	MINUTES of proceedings: before Judge Kathleen M. O'Malley; Court reporter none; status hrg held 7/31/97; Parties to contact the court by 8/8/97 to apprise the court regarding the status of settlement discussions. No exts of the dates in the Case Management Plan are contemplated (issd on 7/31/97) (2 pgs) (pl) [Entry date 08/01/97] [Edit date 03/23/99]
8/4/97	14	STATUS Report by pltf Cleve Indians Co (3 pgs) (dh) [Entry date 08/05/97]
10/9/97	15	NOTICE by deft of filing facts deemed admitted as set for in its request for admissions. (21 pgs) (dh)

DATE	DOCKET NUMBER	PROCEEDINGS
10/31/97	16	ORDER directing pltf to provide responses to deft's 1st set of interr & request for prodctn of docmts by 11/7/97; failure to comply will result in dismissal for failure to prosecute; deft has requested an ext of discovery ddls; however, the Ct feels there is no reason to extend ddls at this time. (issued on 10/31/97) (2 pgs) Judge Kathleen M. O'Malley (dh) [Entry date 11/03/97]
11/10/97	17	MOTION by pltf for protective order (9 pgs) (dh) [Entry date 11/12/97]
11/20/97	18	MOTION by USA for ext of time to conduct discovery & file disp motions w/memo of law. (6 pgs) (dh)
11/20/97	19	MOTION by USA to compel prodctn of docmts or alternatively, to dismiss pltf's complt w/memo of law in support. (60 pgs) (dh)

DATE	DOCKET NUMBER	PROCEEDINGS
11/24/97	20	NOTICE by USA of taking depositions of Cleveland Indians Baseball Company on 12/2/97 & of Major League Baseball Players Association on 12/4/97. (13 pgs) (dh)
11/25/97	21	NOTICE OF SERVICE by USA of docmt subpoena upon the law firm of Morgan Lewis & Bockius. (7 pgs) (dh)
12/5/97	22	RESPONSE by pltf to deft US' mot to compel prodctn of docmts [19-1] (66 pgs) (bb)
12/5/97	–	MARGINAL ENTRY ORDER granting in part motion by USA for ext of time to conduct discovery & file disp motions [18-1]; deft's non-expert discovery to be complete 1/20/98; all other ddls remain intact. (issued on 12/5/97) Judge Kathleen M. O'Malley (dh) [Entry date 12/08/97]
12/5/97	23	PROTECTIVE ORDER re disclosure of "confidential information". (issued on 12/5/97)

DATE	DOCKET NUMBER	PROCEEDINGS
		(5 pgs) Judge Kathleen M. O'Malley (dh) [Entry date 12/08/97]
12/15/97	24	REPLY Memo by deft USA to Cleveland Indians' response to motion to compel prodctn of docmts or alternatively, to dismiss pltf's complt [19-1], [19-2] (79 pgs) (dh)
1/28/98	25	MEMORANDUM AND ORDER granting in part & denying in part USA's motion to compel prodctn of docmts; pltf must produce docmts requested in deft's docmt requests #3, 4, & 5; failure to do so w/in 14 days will result in dismissal of this case purs to FRCP 37(b)(2)(C); pltf will be allowed no ext; [19-1] & denying motion to dismiss pltf's complt [19-2] (issued on 1/28/98) (19 pgs) Judge M. O'Malley (dh) [Entry date 01/29/98]
1/30/98	26	MOTION by pltf for SJ. (44 pgs) (kv)

DATE	DOCKET NUMBER	PROCEEDINGS
1/30/98	27	APPENDIX by pltf to afdvt of Rober A. Dupu (attached to mot) in supp of mot for SJ [26-1]. (one volume) (kv)
2/2/98	28	MOTION (Request) by USA to enlarg time to file disp motions by 30 days. (4 pgs) (dh)
2/2/98	29	ATTORNEY SUBSTITUTION: terminating atty Stephen A. Sherman for USA and substituting atty Glenn J. Melcher. (2 pgs) (dh)
2/5/98	–	MARGINAL ENTRY ORDER granting motion by USA to enlarg time to file disp motions by 30 days. [28-1] Disp mtn filing ddl ext until 4/20/98 (issued on 2/6/98) Judge Kathleen M. O'Malley (dh) [Entry date 02/06/98]
2/19/98	30	JOINT MOTION by ptys to reopen limited discovery, & to enlarg time to respond to pltf's motion for SJ. (3 pgs) (dh)

DATE	DOCKET NUMBER	PROCEEDINGS
2/25/98	–	MARGINAL ENTRY ORDER granting motion by ptys to reopen limited discovery & to enlarg time to respond [30-1], [30-2]; only deft may engage in additional discovery - pltf is barred from further affirmative discovery efforts. No extensions of time of any sort will be granted to pltf. (issued on 2/25/98) Judge Kathleen M. O'Malley (dh) [Entry date 02/26/98]
3/10/98	31	MOTION by deft to dismiss case or at least for other sanctions w/memo of law. (28 pgs) (dh)
4/30/98	32	STIPULATION and ORDER: that USA withdraws its motion for dismissal/sanctions [31-1]/[31-2], denying as moot pltf's motions for SJ. [26-1] and for protective order [17-1]; ct II of the complt is dismissed w/prejudice, jgm on ct I is ordered pltf, entry to abide the final disposition of

DATE	DOCKET NUMBER	PROCEEDINGS
		the case; briefing schedule established for the parties' respective SJ motions on the ct III - 4/29/98, stipulated facts - 5/13/98, initial briefs - 5/27/98, response briefs. (issued on 4/30/98) (3 pgs) Judge Kathleen M. O'Malley (ej) [Entry date 05/01/98]
5/5/98	33	STIPULATED FACTS by parties (8 pgs) (rs)
5/13/98	34	MOTION by deft for SJ (58 pgs) (jam)
5/13/98	35	MOTION by pltf for judgment on stipulated facts (22 pgs) (jam)
5/27/98	36	REPLY Brief by pltf in support of its motion for judgment on stipulated facts [35-1] (9 pgs) (dh) [Entry date 05/28/98]

DATE	DOCKET NUMBER	PROCEEDINGS
1/25/99	37	MEMORANDUM & OPINION granting motion by pltf for judgment on stipulated facts [35-1], & denying motion by deft for SJ [34-1]; jgm is entered in favor of pltfs for a total of $97,202.20, plus int. Dismissing case (issd on 1/26/99) (5 pgs) Judge Kathleen M. O'Malley (dh) [Entry date 01/27/99] [Edit date 03/23/99]
1/25/99	38	ORDER entering judgment in favor of pltf the Cleve Indians Baseball Co, & against deft USA for refunds of FICA taxes in the amt of $96,250.20 plus int from 4/30/94 at the rate dictated by IRC 6621 & 6622; & $952.00 in FUTA taxes plus int from 1/31/95 at the rate fixed by IRC 6621 & 6622. (issued on 1/26/99) (1 pg) Judge Kathleen M. O'Malley (dh) [Entry date 01/27/99]

DATE	DOCKET NUMBER	PROCEEDINGS
2/8/99	39	MAIL Returned addressed to cnsl for pltf, Robert Dupuy, w/insufficient address. (jk) [Entry date 02/09/99]
3/22/99	40	NOTICE of Appeal by USA re: memo and opn [37-2], re: order dismissing case [38-1] (cc: all counsel-notice only. USCA-notice and docs mailed on 3/23/99) (2 pgs) (shh) [Entry date 03/23/99]

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Docket No. 99-3410

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from: Northern District of
Ohio at Cleveland

DOCKET ENTRIES

DATE	PROCEEDINGS
3/31/99	Civil Case Docketed. Notice filed by Appellant USA. Transcript needed: n (cf)
3/31/99	BRIEFING LETTER SENT setting briefing schedule: appellant brief due 5/10/99; appellee brief due 6/9/99; appendix due 6/30/99; final appellant brief due 7/21/99. [99-3410] final appellee brief due 7/21/99;. (cf)

DATE	PROCEEDINGS
4/12/99	APPEARANCE filed by Attorney Michelle O'Connor for Appellant USA [99-3410] (cf)
4/12/99	PRE-ARGUMENT STATEMENT filed by Michelle O'Connor for Appellant USA [99-3410] (cf)
4/14/99	APPEARANCE filed by Attorney James L. Huston for Appellee Clev Indians [99-3410] (cf)
4/16/99	TRANSCRIPT ORDER FORM filed by Glenn J. Melcher for Appellant USA: Transcript not needed. [99-3410] [1927110-1] (blh)
4/19/99	APPEARANCE filed by Attorney Annette G. Butler for Appellant USA [99-3410] (cf)
5/7/99	APPEARANCE filed by Attorney Robert W. Metzler for Appellant USA [99-3410] (cf)
5/7/99	Appellant MOTION filed to extend time to file brief. Motion filed by Robert W. Metzler for Appellant USA. Certificate of service date 5/3/99 [99-3410] (cf)

DATE	PROCEEDINGS
5/7/99	LETTER SENT by cf granting motion to extend briefing [1939636-1] filed by Robert W. Metzler [99-3410] resetting briefing schedule: [99-3410] appellant brief due now 5/24/99; appellee brief now due 6/23/99; appendix now due 7/14/99; appellant final brief now due 8/4/99; appellee final brief now due 8/4/99. (cf)
5/26/99	PETITION for en banc hearing filed by Robert W. Metzler for Appellant USA. Certificate of service date 5/24/99. [99-3410] (blh)
5/26/99	PROOF BRIEF filed by Robert W. Metzler for Appellant USA. Certificate of service date 5/24/99 Number of Pages: 53. [99-3410] (vf)
5/26/99	Request to require oral argument filed by Robert W. Metzler for Appellant USA [99-3410] (vf)
5/28/99	LETTER SENT by cf to hold case in abeyance pending ruling on the petition for rehearing en banc [99-3410], cancelling the briefing schedule (cf)

DATE	PROCEEDINGS
6/11/99	ORDER filed denying petition for en banc hearing [1950454-1] filed by Robert W. Metzler [99-3410]. Entered by order of the court. (blh)
6/18/99	BRIEFING LETTER SENT resetting briefing schedule: appellee brief now due 7/19/99; appendix now due 8/9/99; appellant final brief now due 8/30/99; appellee final brief now due 8/30/99 [99-3410] . (bb)
7/1/99	Appellee MOTION filed to extend time to file brief. Motion filed by James L. Huston for Appellee Clev Indians. Certificate of service date 6/28/99 . [99-3410] (cf)
7/2/99	LETTER SENT by cf granting motion to extend briefing [1972639-1] filed by James L. Huston [99-3410] resetting briefing schedule: [99-3410] appellee brief now due 8/2/99; appendix now due 8/23/99; appellant final brief now due 9/13/99; appellee final brief now due 9/13/99. (cf)
8/5/99	PROOF BRIEF filed by James L. Huston for Appellee Clev Indians. Certificate of service date 8/2/99. Number of Pages: 21. [99-3410] (vf)

DATE	PROCEEDINGS
8/5/99	Request to waive oral argument and submit case on the briefs, (waiver on page: 1), filed by James L. Huston for Appellee Clev Indians [99-3410] (vf)
8/10/99	PROOF REPLY BRIEF filed by Robert W. Metzler for Appellant USA. Certificate of service date 8/6/99. Final reply brief due 9/13/99. [99-3410] (vf)
8/25/99	APPENDIX filed by Robert W. Metzler for Appellant. Copies: 5. Certificate of service date 8/23/99 [99-3410] (vf)
8/31/99	FINAL BRIEF filed by Robert W. Metzler for Appellant USA. Copies: 7. Certificate of service date 8/27/99 Number of Pages: 53. [99-3410] (vf)
8/31/99	FINAL REPLY BRIEF filed by Robert W. Metzler for Appellant USA. Copies: 7 Certificate of service date 8/27/99 Number of Pages: 14. [99-3410] (vf)
9/7/99	FINAL BRIEF filed by James L. Huston for Appellee Clev Indians. Copies: 7. Certificate of service date 9/2/99. Number of Pages: 21. [99-3410] (vf)

DATE	PROCEEDINGS
2/15/00	ADDITIONAL CITATION filed by Robert W. Metzler for Appellant USA. Certificate of service date 2/14/00 [99-3410] (cf)
2/24/00	CAUSE SUBMITTED on briefs to panel consisting of Judges Suhrheinrich, Cole, Quist sitting on 5/3/00. [99-3410] (me)
2/28/00	Appellee RESPONSE to appellant's additional citation filed. Response from James L. Huston for Appellee Clev Indians. Certificate of service date 2/25/00 [99-3410] (cf)
3/7/00	Record requested from district court. (dac)
3/8/00	Submission on briefs date set for May 3, 2000, Notice sent to counsel. (rld)
3/30/00	CERTIFIED RECORD filed. Volumes include 2 Pl. [99-3410] (pb)
5/10/00	Per Curiam OPINION filed: AFFIRMED [99-3410], decision not for publication pursuant to local rule 28(g) [99-3410]. Richard F. Suhrheinrich, Circuit Judge, R. G. Cole, Circuit Judge, Gordon J. Quist, District Judge. (cf)

DATE	PROCEEDINGS
5/19/00	Appellee MOTION filed to publish this court's 5/10/00 opinion [2155867-1]. Motion filed by James L. Huston for Appellee Clev Indians. Certificate of service date 5/16/00. [99-3410] (bb)
5/25/00	RULING denying motion to publish decision of 5/10/00 opinion [2155867-1] filed by James L. Huston [99-3410]. (cf)
7/7/00	MANDATE ISSUED with no cost taxed [99-3410] (dac)
7/12/00	CERTIFIED RECORD RETURNED to lower court at the end of appellate proceedings. [99-3410]. Volumes included: 2 Pl;. (dac)
8/9/00	Record acknowledgment received from the district court. Acknowledged by: Shawn Harrigan. Acknowledgment date: 8/4/00. [99-3410] (dac)
9/6/00	U.S. Supreme Court notice filed regarding petition for writ of certiorari filed by Appellant USA. Filed in the Supreme Court on 08-08-00 , Supreme Ct. case number: 00-203. [99-3410] (swh)

UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

Case No. 1:96CV2240
Judge O'Malley

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP, PLAINTIFF

v.

UNITED STATES OF AMERICA, DEFENDANT

STIPULATED FACTS

Plaintiff Cleveland Indians Baseball Company and defendant United States of America, by their undersigned attorneys, stipulate without prejudice to any position that either party may take in any other action to the following facts:

1. The relationship between Major League Baseball Players Association ("MLBPA") and the Major League Baseball Clubs (the "Clubs") is and was at all times material to the Complaint herein covered by a Collective Bargaining Agreement ("CBA"), which deals with the overall terms and conditions of players' employment that are collective in nature.

2. Article XVIII(H) of the CBA prohibits concerted action by players or Clubs in dealing with

free agents. Free Agents are those players who are not bound or reserved to a Club by contract for an upcoming baseball season.

3. Individual players sign a Uniform Player Contract ("UPC") with an individual Club, the standard form of which was negotiated between the MLBPA and the Clubs. Depending on individual players' success in bargaining for themselves, the UPC might include salaries greater than the minimum, bonuses, deferred compensation, or other special covenants or conditions of employment.

4. Under the CBA, grievances are submitted to an arbitration panel for resolution and binding arbitration. The arbitration panel can fashion whatever remedy it deems appropriate, including requiring the clubs to pay salary as damages if the terms of the CBA have been violated. Pursuant to the CBA, the MLBPA filed three separate grievances claiming that the Clubs breached the CBA before the 1986, 1987 and 1988 seasons, with the result that players suffered damages from 1986 through at least 1990. Specifically, the MLBPA contended that the Clubs acted in concert in violation of Article XVIII(H) and, because of the inter-relationship between free agency and all other aspects of the employment relationship, this concerted action was alleged to have deprived free agents and players at all seniority levels of direct and consequential benefits that would otherwise have been available to them.

5. After evidentiary hearings, the duly constituted arbitration panel in three separate decisions found that the Clubs had, in fact, interfered with the contractual rights of the players before the 1986, 1987 and 1988 seasons by acting in concert (1) to preclude or hinder

players who were free agents from leaving their previous Clubs after the 1985 and 1986 baseball seasons, and (2) to depress overall salary levels and the levels of other contract benefits and special covenants after the 1987 baseball season by sharing information as to what offers were being made to free agent players. As a result of the Clubs' found violation of the CBA, the Arbitration Panel held on August 29, 1989, that the players collectively suffered damages from loss of salary in 1986 of $10,040,000.00. On September 17, 1990, the Arbitration Panel held that the players' collectively suffered damages from loss of salary for the 1987 and 1988 baseball seasons of $37,560,000.00 and $66,340,000.00, respectively. The Arbitration Panel did not attempt to determine what any individual player's salary may have been in the absence of collusion.

6. Before the arbitration panel rendered its final decision as to salary damages for years other than 1986, 1987 and 1988, and its decision as to the applicability of other claims for damages or injury made by the MLBPA for all years, the Clubs and the MLBPA settled the three grievances on December 21, 1990. The settlement required the Clubs to pay $280 million into two custodial accounts to be administered by a custodian, for later distribution, pursuant to a distribution plan approved by the Arbitration Panel, to the players who had suffered damages. The exhibit to the Settlement Agreement provided for the allocation of the total damages for 1986 and 1987 based in part on the amount of the Arbitration Panel's awards in the August 29, 1989 decision and the September 17, 1990, decision. Under the settlement, the Clubs were not to have (and did not have) any responsibility for or input into the distribution decisions. Like the Arbitration

Panel decisions, the Settlement Agreement did not establish sums that would be paid to individual players. The Settlement Agreement also provided that the custodian would withhold from any distributions, acting solely as agent for each of the Clubs, the required amount of employment taxes to be deducted from the distributions to players from the accounts.

7. Under the CBA, a respondent Club or Clubs has the right to argue the amount of any damages for any violation of the CBA under the arbitration procedure. In these three grievances, the Clubs provided arguments and briefs as part of the decision of the Arbitration Panel as to the amount of loss of overall industry salary for the 1986, 1987 and 1988 years resulting from violation of the CBA. As part of the Settlement Agreement, the MLBPA had exclusive authority to propose the Framework and all distribution plans thereunder.

8. The Settlement Agreement provides that the Arbitration Panel would be empowered to make the final decision as to the approval of the terms of any distribution plan. The distribution plan was to be developed by the MLBPA and submitted to the Arbitration Panel for approval. First, the MLBPA drafted a Framework for distribution, proposed it to its members for comment, and the Framework was ultimately approved by the Arbitration Panel.

9. Pursuant to the Framework, the MLBPA proposed a partial distribution plan to the arbitrators on December 8, 1992 under the Settlement Agreement and Framework, providing for payments to individual players whose claims for damages related to the 1986 and 1987 seasons.

10. The arbitrator made his first awards under the Framework on February 14, 1994. As the Framework required, and as the parties had done in their overall Settlement Agreement, the awards distinguished base damages awards from interest components. As in the Settlement Agreement, interest was calculated at the U.S. government treasury bill rate, in accordance with the Settlement Agreement and Framework.

11. For purposes of liability for FICA and FUTA taxes the Cleveland Indians Baseball Company is the employer with respect to the payment of the 1986 damage awards and the 1987 damage awards for certain players. All players who received settlement payments from the Cleveland Indians were employees of the Cleveland Indians during 1986 and 1987, except for one player who was an employee of the Cleveland Indians during 1986 and is deemed to be an employee for purposes of a damage award for 1987 pursuant to the Settlement Agreement because the Cleveland Indians were the last club prior to the 1987 season which employed that player.

12. Pursuant to the Settlement Agreement and the MLBPA's proposals for distributions, the arbitrator ordered distributions with respect to the 1986 and 1987 seasons in a written award dated February 14, 1994. As a result, on or about March 1, 1994, eight players who were employees of the Cleveland Indians in 1986 received distributions with respect to the 1986 season (1986 damage awards), and fourteen players who were employees of the Cleveland Indians in 1987 and one who was deemed to be an employee in 1987 received distributions with respect to the 1987 season (1987 damage awards). None of these players performed

services for the Cleveland Indians in 1994. The awards were received in checks drawn on the custodial account, less FICA tax and income tax withholding, from the custodian of the custodial account. There was some duplication, so that a total of 18 separate players received awards allocated to the Cleveland Indians for 1986 and 1987.

13. The 1986 damage awards for Cleveland Indians players constituted wages totaling $610,000, and these players also received $219,638 in interest. The 1987 damage awards for Cleveland Indians players constituted wages totaling $1,457,848, and these players also received $409,119.17 in interest.

14. On March 23, 1993, The Clubs asked the IRS for a ruling on the payroll tax treatment of these settlement distributions. Because the IRS had not yet responded when the 1986 and 1987 awards were made in 1994, the Cleveland Indians paid the employer's share of FICA and FUTA taxes on the entire awards as if they were wages paid in 1994. The FICA tax payment was $99,381.90, and the FUTA payment was $1,008.

15. The IRS issued its private letter ruling on October 18, 1995. On February 21, 1996, the Cleveland Indians filed claims with the IRS for refunds of the FICA and FUTA taxes for the 1st Quarter, 1994 and 1994 calendar year, respectively. Sixteen of the 18 players have consented to join the refund claims. The IRS has neither allowed nor denied the claims for refund.

16. As to Count I of the complaint, the parties have now stipulated that the Cleveland Indians are entitled

to a refund of FICA payments on the interest portions of these awards of $13,071.10, with judgment to be entered at the conclusion of proceedings in this Court. The Cleveland Indians are also entitled to interest on this amount from April 30, 1994, at the rate fixed by the Internal Revenue Code ("IRC") §§ 6621 and 6622. IRC § 6611(b)(2). The Cleveland Indians are not entitled to any refund from FUTA taxes as to Count 1 of the Complaint, because the damages amount for each player was in excess of the FUTA wage base.

17. Count II of the Complaint has been dismissed by stipulation, with prejudice.

18. Count III of the Complaint remains for determination by the Court upon these stipulated facts. If the Court determines that these awards should be treated as attributable for FICA tax and FUTA tax purposes to the tax years 1986 and 1987, the Cleveland Indians should have judgment for $96,250.20 (FICA) and $952.00 (FUTA). (This amount is inclusive of the amount in Paragraph 16 above.) The Cleveland Indians also will be entitled to interest on these amounts from April 30, 1994 for FICA and January 31, 1995 for FUTA, at the rate fixed by IRC §§ 6621 and 6622. IRC § 6611(b)(2). But, if the Court determines that these awards should be treated as attributable for FICA tax and FUTA tax purposes to the tax year 1994, the

Government should have judgment dismissing Count III.

ROBERT A. DUPUY #1014584

/s/ ROBERT A. DUPUY
Attorneys for Cleveland
Indians Baseball Company

FOLEY & LARDNER
777 East Wisconsin Avenue
Milwaukee, WI 53202-5367
414-271-2400
414-297-4900(fax)

OF COUNSEL:

Michael K. Farrell
Baker & Hostetler LLP
3200 National City Center
1900 East 9th Street
Cleveland, Ohio 44114-3485
216-621-0200
216-696-0740(fax)

GLENN J. MELCHER

/s/ GLENN J. MELCHER
Attorney for United States
of America

Trial Attorney, Tax Division
U.S. Department of Justice
Post Office Box 55
Washington, D.C. 20044
202-307-1099
202-514-5238(fax)

STATUTORY PROVISIONS

1. 26 U.S.C. 3101 provides in relevant part:

(a) Old-age, survivors, and disability insurance.

In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

In cases of wages received during:	**The rate shall be:**
1984, 1985, 1986, or 1987	5.7 percent
1988 or 1989	6.06 percent
1990 or thereafter	6.2 percent.

(b) Hospital insurance.

In addition to the tax imposed by the preceding subsection, there is hereby imposed on the income of every individual a tax equal to the following percentages of the wages (as defined in section 3121(a)) received by him with respect to employment (as defined in section 3121(b))—

(1) with respect to wages received during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

(2) with respect to wages received during the calendar year 1978, the rate shall be 1.00 percent;

(3) with respect to wages received during the calendar years 1979 and 1980, the rate shall be 1.05 percent;

(4) with respect to wages received during the calendar years 1981 through 1984, the rate shall be 1.30 percent;

(5) with respect to wages received during the calendar year 1985, the rate shall be 1.35 percent; and

(6) with respect to wages received after December 31, 1985, the rate shall be 1.45 percent.

* * * * *

2. 26 U.S.C. 3111 provides in relevant part:

(a) Old-age, survivors, and disability insurance.— In addition to other taxes, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

In cases of wages paid during:	**The rate shall be:**
1984, 1985, 1986, or 1987	5.7 percent
1988 or 1989	6.06 percent
1990 or thereafter	6.2 percent.

(b) Hospital insurance.—

In addition to the tax imposed by the preceding subsection, there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 3121(a)) paid by him with respect to employment (as defined in section 3121(b))—

(1) with respect to wages paid during the calendar years 1974 through 1977, the rate shall be 0.90 percent;

(2) with respect to wages paid during the calendar year 1978, the rate shall be 1.00 percent;

(3) with respect to wages paid during the calendar years 1979 and 1980, the rate shall be 1.05 percent;

(4) with respect to wages paid during the calendar years 1981 through 1984, the rate shall be 1.30 percent;

(5) with respect to wages paid during the calendar year 1985, the rate shall be 1.35 percent; and

(6) with respect to wages paid after December 31, 1985, the rate shall be 1.45 percent.

* * * * *

3. 26 U.S.C. 3121 provides in relevant part:

(a) Wages.—

For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) in the case of the taxes imposed by sections 3101(a) and 3111(a) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) with respect to employment has been paid to an individual by an employer during the calendar year with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year. If an employer (hereinafter referred to as successor employer) during any calendar year acquires substantially all the property used in a trade or business of another employer (hereinafter referred to as a predecessor), or used in a separate unit of a trade or business of a predecessor, and immediately after the acquisition employs in his trade or business an individual who immediately prior to the acquisition was employed in the trade or business of such predecessor, then, for the purpose of determining whether the successor employer has paid remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment equal to the contribution and benefit

base (as determined under section 230 of the Social Security Act) to such individual during such calendar year, any remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) with respect to employment paid (or considered under this paragraph as having been paid) to such individual by such predecessor during such calendar year and prior to such acquisition shall be considered as having been paid by such successor employer;

* * * * *

(v) Treatment of certain deferred compensation and salary reduction arrangements.

(1) Certain employer contributions treated as wages.—

Nothing in any paragraph of subsection (a) (other than paragraph (1)) shall exclude from the term "wages"—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not included in gross income by reason of section 402(e)(3), or

(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

(2) Treatment of certain nonqualified deferred compensation plans

(A) In general.—

Any amount deferred under a nonqualified deferred compensation plan shall be taken into account for purposes of this chapter as of the later of—

(i) when the services are performed, or

(ii) when there is no substantial risk of forfeiture of the rights to such amount.

The preceding sentence shall not apply to any excess parachute payment (as defined in section 280G(b)).

(B) Taxed only once.—

Any amount taken into account as wages by reason of subparagraph (A) (and the income attributable thereto) shall not thereafter be treated as wages for purposes of this chapter.

(C) Nonqualified deferred compensation plan.—

For purposes of this paragraph, the term "nonqualified deferred compensation plan" means any plan or other arrangement for deferral of compensation other than a plan described in subsection (a)(5).

* * * * *

4. 26 U.S.C. 3301 (1994 & Supp. IV 1998) provides:

There is hereby imposed on every employer (as defined in section 3306(a)) for each calendar year an excise tax, with respect to having individuals in his employ, equal to—

(1) 6.2 percent in the case of calendar years 1988 through 2007; or

(2) 6.0 percent in the case of calendar year 2008 and each calendar year thereafter;

of the total wages (as defined in section 3306(b)) paid by him during the calendar year with respect to employment (as defined in section 3306(c)).

5. 26 U.S.C. 3306 provides in relevant part:

* * * * *

(b) Wages.—

For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include—

(1) that part of the remuneration which, after remuneration (other than remuneration referred to in the succeeding paragraphs of this subsection) equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year, is paid to such individual by such employer during such calendar year.

* * * * *

(r) Treatment of certain deferred compensation and salary reduction arrangements

(1) Certain employer contributions treated as wages.

Nothing in any paragraph of subsection (b) (other than paragraph (1)) shall exclude from the term "wages"—

(A) any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not included in gross income by reason of section 402(e)(3), or

(B) any amount treated as an employer contribution under section 414(h)(2) where the pickup referred to in such section is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise).

(2) Treatment of certain nonqualified deferred compensation plans

(A) In general

Any amount deferred under a nonqualified deferred compensation plan shall be taken into account for purposes of this chapter as of the later of—

(i) when the services are performed, or

(ii) when there is no substantial risk of forfeiture of the rights to such amount.

(B) Taxed only once

Any amount taken into account as wages by reason of subparagraph (A) (and the income attributable thereto) shall not thereafter be treated as wages for purposes of this chapter.

(C) Nonqualified deferred compensation plan.

For purposes of this paragraph, the term "nonqualified deferred compensation plan" means any plan or other arrangement for deferral of compensation other than a plan described in subsection (b)(5).

* * * * *

6. 26 C.F.R. 31.3101-2 provides in relevant part:

* * * * *

(c) *Computation of employee tax.* The employee tax is computed by applying to the wages received by the employee the rate in effect at the time such wages are received.

Example. In 1972, employee A performed for employer X services which constituted employment (see § 31.3121(b)-2). In 1973 A receives from X $1,000 as remuneration for such services. The tax is payable at the 5.85 percent rate (4.85 percent plus 1.0 percent) in effect for the calendar year 1973 (the year in which the wages are received) and not at the 5.2 percent rate which was in effect for the calendar year 1972 (the year in which the services were performed).

7. 26 C.F.R. 31.3101-3 provides:

The employee tax attaches at the time that the wages are received by the employee. For provisions relating to the time of such receipt, see § 31.3121(a)-2.

8. 26 C.F.R. 31.3111-2 provides in relevant part:

* * * * *

(c) *Computation of employer tax.* The employer tax is computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid.

9. 26 C.F.R. 31.3111-3 provides:

The employer tax attaches at the time that the wages are paid by the employer. For provisions relating to the time of such payment, see § 31.3121(a)-2.

10. 26 C.F.R. 31.3121(a)-2 provides in relevant part:

(a) In general, wages are received by an employee at the time that they are paid by the employer to the employee. Wages are paid by an employer at the time that they are actually or constructively paid unless under paragraph (c) of this section they are deemed to be subsequently paid. For provisions relating to the time when tips received by an employee are deemed paid to the employee, see § 31.3121(q)-1.

(b) Wages are constructively paid when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at any time although not then actually reduced to possession. To constitute payment in such a case the wages must be

credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that they may be drawn upon at any time, and their payment brought within his own control and disposition. For provisions relating to the treatment of deductions from remuneration as payments of remuneration, see § 31.3123-1.

* * * * *

11. 26 C.F.R. 31.3121(a)(1)-1(a)(2) provides:

The annual wage limitation applies only if the remuneration received during any 1 calendar year by an employee from the same employer for employment performed after 1936 exceeds the amount of such limitation. The limitation in such case relates to the amount of remuneration received during any 1 calendar year for employment after 1936 and not to the amount of remuneration for employment performed in any 1 calendar year.

Example. Employee A, in 1967 receives $7,000 from employer B in part payment of $8,000 due him from employment performed in 1967. In 1968 A receives from employer B the balance of $1,000 due him for employment performed in 1967, and thereafter in 1968 also receives $7,000 for employment performed in 1968 for employer B. The first $6,600 of the $7,000 received during 1967 is subject to the taxes in 1967. The remaining $400 received in 1967 is not included as wages and is not subject to the taxes. The balance of $1,000 received in 1968 for employment during 1967 is subject to the taxes during 1968 as is also the first $6,800 of the

$7,000 thereafter received in 1968 ($1,000 plus $6,800 totaling $7,800, which is the annual wage limitation applicable to remuneration received in 1968 by an employee from any one employer). The remaining $200 received in 1968 is not included as wages and is not subject to the taxes.

* * * * *

12. 26 C.F.R. 31.3301-2 provides:

The tax for any calendar year is measured by the amount of wages paid by the employer during such year with respect to employment after December 31, 1938. (See § 31.3306(b)-1, relating to wages, and §§ 31.3306(c)-1 to 31.3306(c)-3, inclusive, relating to employment.)

13. 26 C.F.R. 31.3306(b)(1)-1 provides in relevant part:

(a) *In general.* (1) The term "wages" does not include that part of the remuneration paid within any calendar year by an employer to an employee which exceeds the first $3,000 of remuneration (exclusive of remuneration excepted from wages in accordance with paragraph (j) of § 31.3306(b)-1 or §§ 31.3306(b)(2)-1 to 31.3306(b)(8)-1, inclusive), paid within such calendar year by such employer to such employee for employment performed for him at any time after 1938.

(2) The $3,000 limitation applies only if the remuneration paid during any one calendar year by an employer to the same employee for employment performed after 1938 exceeds $3,000. The limitation in such case relates to the amount of remuneration paid during any one calendar year for employment after

1938 and not to the amount of remuneration for employment performed in any one calendar year.

Example. Employer B, in 1955, pays employee A $2,500 on account of $3,000 due him for employment performed in 1955. In 1956 employer B pays employee A the balance of $500 due him for employment performed in the prior year (1955), and thereafter in 1956 also pays A $3,000 for employment performed in 1956. The $2,500 paid in 1955 is subject to tax in 1955. The balance of $500 paid in 1956 for employment during 1955 is subject to tax in 1956, as is also the first $2,500 paid of the $3,000 for employment during 1956 (this $500 for 1955 employment added to the first $2,500 paid for 1956 employment constitutes the maximum wages subject to the tax which could be paid in 1956 by B to A). The final $500 paid by B to A in 1956 is not included as wages and is not subject to the tax.

* * * * *

Supreme Court, U.S.
FILED
NOV 29 2000
CLERK

(4)

No. 00-203

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY, A LIMITED PARTNERSHIP

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

SETH P. WAXMAN
Solicitor General
Counsel of Record
PAULA M. JUNGHANS
Acting Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
KENNETH L. GREENE
ROBERT W. METZLER
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202)514-2217

QUESTION PRESENTED

Whether, for purposes of the Federal Insurance Contributions Act, 26 U.S.C. 3101-3128, and the Federal Unemployment Tax Act, 26 U.S.C. 3301-3311, an award of back wages should be attributed to the year in which the award was actually paid or, instead, to the year in which the events that gave rise to the award occurred.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statutory provisions and regulations involved	2
Statement	2
Summary of argument	8
Argument:	
For FICA and FUTA tax purposes, an award of back wages is to be attributed to the year in which the award is actually paid, and not to the year or years in which the events occurred that gave rise to the award	11
A. The plain language of the relevant statutes, their legislative history, and the applicable treasury regulations demonstrate that back wages are to be attributed to the year of payment for FICA and FUTA tax purposes	11
1. The FICA provisions	13
2. The FUTA provisions	21
B. The *Bowman* case, on which the court of appeals based its decision, was wrongly decided	25
Conclusion	35

TABLE OF AUTHORITIES

Cases:

Atlantic Mut. Ins. Co. v. *Commissioner*, 523 U.S. 382 (1998)	20
Bowman v. *United States*, 824 F.2d 528 (6th Cir. 1987)	7, 9, 26, 28
Cottage Sav. Ass'n v. *Commissioner*, 499 U.S. 554 (1991)	9, 20
Flemming v. *Nestor*, 363 U.S. 603 (1960)	28

Cases—Continued: Page

Freedomland, Inc., In re, 480 F.2d 184 (2d Cir. 1973), aff'd *sub nom. Otte* v. *United States*, 419 U.S. 43 (1974) 30, 31
Hemelt v. *United States*, 122 F.3d 204 (4th Cir. 1997) 10, 33, 34
Johnston v. *Harris County Flood Control Dist.*, 869 F.2d 1565 (5th Cir. 1989) 33
Mazur v. *Commissioner*, 986 F. Supp. 752 (W.D. N.Y. 1997) 28
National Muffler Dealers Ass'n v. *United States*, 440 U.S. 472 (1979) 20
Otte v. *United States*, 419 U.S. 43 (1974) 10, 31, 32
Social Security Board v. *Nierotko*, 327 U.S. 358 (1946) 9, 10, 26, 27
United States v. *Correll*, 389 U.S. 299 (1967) 20, 25
Walker v. *United States*, 202 F.3d 1290 (10th Cir. 2000) 10, 29, 34, 35

Statutes and regulations:

Act of July 1, 1972, Pub. L. No. 92-336, § 202(b)(1), 86 Stat. 416 (42 U.S.C. 430) 4
Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 502, 88 Stat. 891 33
Employment Security Amendments of 1970, Pub. L. No. 91-373, § 302, 84 Stat. 713 25
Federal Insurance Contribution Act (Internal Revenue Code of 1986, Ch. 21), 26 U.S.C. 3101-3128 ..... *passim*
26 U.S.C. 3101 ..... 2, 12, 19
26 U.S.C. 3101(a) 3, 4, 12, 13, 14, 32
26 U.S.C. 3101(b) 3, 4, 12, 13
26 U.S.C. 3102 5
26 U.S.C. 3102(a) 14, 31
26 U.S.C. 3111 ..... 2, 12, 19
26 U.S.C. 3111(a) 3, 4, 8, 11-12, 13, 14

Statutes and regulations—Continued: Page

26 U.S.C. 3111(b) 3, 4, 8, 11-12, 13
26 U.S.C. 3121 2
26 U.S.C. 3121(a) 4, 5, 19
26 U.S.C. 3121(a) (1982 & Supp. III 1985) 4
26 U.S.C. 3121(a)(1) 4, 12, 14, 16-17, 20
26 U.S.C. 3121(a)(1) (1982) 12
26 U.S.C. 3121(v)(2) 17
Federal Unemployment Tax Act (Internal Revenue Code of 1986, Ch. 23), 26 U.S.C. 3301-3311 ..... *passim*
26 U.S.C. 3301 ..... 2, 4, 5, 8, 12, 21
26 U.S.C. 3306 2
26 U.S.C. 3306(b) 5
26 U.S.C. 3306(b)(1) 12, 21, 23, 24
26 U.S.C. 3306(r)(2) 17
Internal Revenue Code of 1939, § 1426(a)(1), 26 U.S.C. 1426(a)(1) (1940) 17
Internal Revenue Code of 1986, 26 U.S.C. 1 *et seq.*:
26 U.S.C. 31(b) 31
26 U.S.C. 3402 5
26 U.S.C. 3402(a) 32
26 U.S.C. 6413(c)(1) 14, 30, 31
Self-Employment Contributions Act of 1954, 42 U.S.C. 1401 34
Social Security Act, ch. 531, 49 Stat. 620 (42 U.S.C. 301-1397jj) 11, 14, 17, 22, 24, 26, 27
Tit. II, 49 Stat. 622 ..... 9-10, 27
§ 210(a), 49 Stat. 625 ..... 26, 27
§ 210(b), 49 Stat. 625 27
Tit. VIII, 49 Stat. 636 26
§ 801, 49 Stat. 636 ..... 8, 15
§ 804, 49 Stat. 637 ..... 8, 15
§ 811(a), 49 Stat. 639 ..... 17, 26
Tit. IX, 49 Stat. 639:
§ 901, 49 Stat. 639 ..... 22, 24
§ 907(b), 49 Stat. 642 24

Statutes and regulations—Continued: Page

Social Security Act Amendments of 1939, ch. 666, 53 Stat. 1360:
- Tit. II, 53 Stat. 1362 (42 U.S.C. 401 *et seq.*) 27
- Tit. VI, 53 Stat. 1381 (26 U.S.C. 1400 *et seq.* (1940)):
  - § 601, 53 Stat. 1382 ..... 8, 15
  - § 604, 53 Stat. 1383 ..... 8, 15
  - § 608, 53 Stat. 1387 22

Social Security Act Amendments of 1946, ch. 951, 60 Stat. 978:
- § 412(a), 60 Stat. 989 ..... 9, 17
- § 412(b), 60 Stat. 989 ..... 9, 24
- § 414(a)(3), 60 Stat. 991 ..... 10, 27

Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 271(a), 96 Stat. 554 25

Unemployment Compensation Amendments of 1976, Pub. L. No. 94-566, § 211(a), 90 Stat. 2676 25

Treas. Reg.:
- Reg. 91 (1936):
  - Art. 202 15
  - Art. 302 15
- Reg. 106 (1940):
  - § 402.301 19
  - § 402.302 ..... 16, 19
  - § 402.303 19
  - § 402.401 19
  - § 402.402 ..... 16, 19
  - § 402.403 19
- Reg. 106 (as amended by T.D. 5566, 1947-2 C.B. 148) 19
- Reg. 107 (as amended by T.D. 5566, 1947-C.B. 148) 19

20 C.F.R. 404.1242 28

26 C.F.R.:
- Section 31.3101-2(c) 2, 19
- Section 31.3101-3 ..... 2, 19
- Section 31.3111-2(c) 2, 19
- Section 31.3111-3 ..... 2, 19

Regulations—continued Page
- Section 31.3121(a)-2 2
- Section 31.3121(a)-2(a) 19, 34
- Section 31.3121(a)(1)-1(a)(2) 2, 20
- Section 31.3301-2 ..... 2, 24
- Section 31.3301-3(b) 24
- Section 31.3306(b)(1)-1 2
- Section 31.3306(b)(1)-1(a)(1) 25
- Section 31.3306(b)(1)-1(a)(2) 25

Miscellaneous:

W. Cohen, *The Development of the Social Security Act of 1935: Reflections Some Fifty Years Later*, 6 Soc. Sec. Rep. Ser. 933 (1984) 11, 12

50 Fed. Reg. 45,559 (1985) 4

51 Fed. Reg. 40,257 (1986) 4

58 Fed. Reg. 58.004 (1993) 4

K. W. Gideon, *Lawsuits and Settlements* (1995) 29

H.R. Rep. No. 1337, 83d Cong., 2d Sess. (1954) 18

H.R. Rep. No. 2447, 79th Cong., 2d Sess. (1946) 18, 24, 28

H.R. Rep. No. 728, 76th Cong., 1st Sess. (1939) 16, 22, 30

Rev. Rul. 55-203, 1955-1 C.B. 114 20

Rev. Rul. 57-92, 1957-1 C.B. 306 20

Rev. Rul. 78-336, 1978-2 C.B. 255 20

Rev. Rul. 89-35, 1989-1 C.B. 280 20

S. Rep. No. 734, 76th Cong., 1st Sess. (1939) 16, 22, 30

S. Rep. No. 1862, 79th Cong., 2d Sess. (1946) 18, 24, 28

S. Rep. No. 1622, 83d Cong., 2d Sess. (1954) 18

SSA, Dep't of Health & Human Servs., *Reporting Reporting Back Pay and Special Wages Payments to the Soc. Sec. Admin.*, Pub. L. No. 957 (Sept. 1997) 28

SSA, Dep't of Health & Human Servs., SSR 83-7, 1981-1991 Soc. Sec. Rep. Serv. (1983) 28

T.D. 5566, 1947-2 C.B. 148 19

T.D. 6516, 25 Fed. Reg. 13,032 (1960) 19

In the Supreme Court of the United States

No. 00-203

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-5a) is unpublished, but the decision is noted at 215 F.3d 1325 (Table). The opinion of the district court (Pet. App. 6a-11a) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on May 10, 2000. The petition for a writ of certiorari was filed on August 8, 2000, and was granted on October 16, 2000. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTORY PROVISIONS AND REGULATIONS INVOLVED

The relevant portions of Sections 3101, 3111, 3121, 3301, and 3306 of the Internal Revenue Code, 26 U.S.C. 3101, 3111, 3121, 3301, and 3306, and of Sections 31.3101-2(c), 31.3101-3, 31.3111-2(c), 31.3111-3, 31.3121(a)-2, 31.3121(a)(1)-1(a)(2), 31.3301-2, and 31.3306(b)(1)-1 of the Treasury Regulations on Employment Taxes and Collection of Income Tax at Source, 26 C.F.R. 31.3101-2(c), 31.3101-3, 31.3111-2(c), 31.3111-3, 31.3121(a)-2, 31.3121(a)(1)-1(a)(2), 31.3301-2, and 31.3306(b)(1)-1, are set forth at J.A. 21-30.

STATEMENT

1. Respondent is one of 26 major league baseball clubs that are parties to a collective bargaining agreement negotiated with the Major League Baseball Players Association. Pet. App. 7a. The players association filed grievances claiming that, in 1986, 1987, and 1988, the clubs violated the free agency rights of the players under the collective bargaining agreement. *Id.* at 2a, 7a. An arbitration panel issued rulings in 1990 concluding that the clubs had interfered with the players' free agency rights and thereby depressed the players' salaries. To settle these grievances, the clubs agreed to pay $280 million into two accounts administered by a custodian for distribution to the players who had suffered damages. *Ibid.* The custodian was required to establish separate accounts for each of the clubs and, acting as agent for the clubs, was to deduct from the settlement payments any applicable federal income or employment taxes required to be withheld. J. A. 24; C.A. App. 37.

Under the agreed distribution plan, eight players who were employees of respondent during 1986, and

fourteen players who were employees of respondent during 1987, received awards. The awards were paid in 1994. Pet. App. 3a, 7a.[1] These payments aggregated $829,338 (including $219,638 denominated as interest) for violations of the collective bargaining agreement occurring in 1986 and $1,866,967 (including $409,119 denominated as interest) for violations occurring in 1987. *Id.* at 2a, 8a; J.A. 26; C.A. App. 11-12.

2. As part of the Federal Insurance Contributions Act (FICA), Section 3101(a) and (b) of the Internal Revenue Code "impose[] on the income of every individual" taxes to fund Social Security and Medicare "equal to [a percentage] of the wages (as defined in section 3121(a)) received by him with respect to employment." 26 U.S.C. 3101(a), (b). Similarly, Sections 3111(a) and (b) "impose[] on every employer" taxes to fund Social Security and Medicare "equal to [a percentage] of the wages (as defined in section 3121(a)) paid by him with respect to employment." 26 U.S.C. 3111(a), (b). For both employers and employees, the percentage of wages to be paid as Social Security tax under Sections 3101(a) and 3111(a) was 5.7 percent in 1986 and 1987 and rose to 6.2 percent by 1994. 26 U.S.C. 3101(a), 3111(a). The percentage of wages paid by employers and employees as the Medicare tax under Sections 3101(b) and 3111(b) has been 1.45 percent since 1986. 26 U.S.C. 3101(b), 3111(b).

---

[1] One player who was not actually employed by respondent during 1987 also received an award in 1994 that was treated as attributable to 1987 under the settlement arrangement. The district court stated that this was because, even though "he was no longer in baseball in 1994, he was 'deemed' an employee of the last team to employ him—the Indians." Pet. App. 7a n.1.

The term "wages" is defined for purposes of the Social Security tax provisions (Sections 3101(a) and 3111(a)) to mean "all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash," with certain exceptions. 26 U.S.C. 3121(a). As relevant here, wages do *not* include "that part of the remuneration which, after remuneration * * * equal to the contribution and benefit base (as determined under section 230 of the Social Security Act) with respect to employment has been paid to an individual by an employer during the calendar year with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year." 26 U.S.C. 3121(a)(1).[2] This definition of wages also applied for purposes of Sections 3101(b) and 3111(b) in 1986 and 1987. 26 U.S.C. 3121(a) (1982 & Supp. III 1985). By 1994, however, when the settlement award payments were made in this case, "wages" had been defined so that the exclusion for amounts in excess of the contribution and benefit base no longer applied for purposes of the Medicare tax provisions (Sections 3101(b) and 3111(b)). See 26 U.S.C. 3121(a)(1).

In addition, as part of the Federal Unemployment Tax Act (FUTA), Section 3301 "impose[s] on every employer * * * for each calendar year an excise tax, with respect to having individuals in his employ, equal

[2] The contribution and benefit base is a fixed dollar amount for a particular year determined under the formula contained in Section 230 of the Social Security Act, 42 U.S.C. 430. In 1994, the base was $60,600. 58 Fed. Reg. 58,004 (1993). In 1986, the base was $42,000. 50 Fed. Reg. 45,559 (1985). In 1987, it was $43,800. 51 Fed. Reg. 40,257 (1986).

to * * * [a percentage] of the total wages * * * paid by him during the calendar year with respect to employment * * * ." 26 U.S.C. 3301. During the relevant years, the applicable percentage of wages constituting this tax was 6.2 percent. *Ibid.* The term "wages" is defined for purposes of Section 3301 in the same manner as in Section 3121(a), except "wages" for unemployment tax purposes do not include "remuneration * * * after * * * equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year * * * ." 26 U.S.C. 3306(b).

3. When the amounts awarded to respondent's players were paid in 1994, FICA and income taxes were withheld by the custodian, on behalf of respondent, from the amounts paid.[3] Respondent thereafter filed an employment tax return for the first quarter of 1994. That return reported employer and employee FICA taxes attributable to the settlement payments based on the entire amount of the awards made in 1994 and using the rates and annual ceilings on wages in effect for the 1994 year. Pet. App. 2a-3a, 7a-8a; J.A. 26-27; C.A. App. 13, 28. Respondent also filed a return for the calendar year 1994 that reported FUTA taxes attributable to the settlement payments, again based on the entire amount of the awards made in 1994 and using the rates and annual ceilings on wages in effect for the 1994 year. Pet. App. 2a-3a, 7a-8a. Having remitted the withheld taxes, respondent filed a claim for refund that sought to recover both the employer's share of the FICA and FUTA taxes it paid *and* the FICA taxes withheld from

[3] Pursuant to 26 U.S.C. 3102, 3402, employers are generally required to withhold from the wages of their employees the employee's share of the FICA tax and income taxes.

those employees who consented to join in the claim. C.A. 93. When the claim for refund was not granted within six months, respondent filed this tax refund suit in district court to recover the employer's share of the FICA taxes and the FUTA taxes that it paid. Pet. App. 3a, 8a.[4]

Respondent raised several claims. First, respondent asserted that a portion of the award paid in 1994 was "interest," which is not subject to employment tax. Second, respondent asserted that the non-interest portion of the award paid in 1994 did not constitute "wages" within the meaning of the employment tax statutes. And, third, respondent asserted that, if any portion of the award paid in 1994 constituted "wages," it should be attributed for FICA and FUTA tax purposes to 1986 or 1987 (when the annual wage ceiling had been exceeded by each of the affected players), rather than to 1994, when the awards were paid. As a result, respondent claimed that no FICA or FUTA taxes were due from the 1994 awards. Pet. App. 3a.

The parties stipulated (i) that the "interest" portion of the awards paid in 1994 did not constitute "wages" and (ii) that the remainder of those awards constituted back wages for the years 1986 and 1987. Pet. App. 3a-4a. The parties then filed cross-motions for summary judgment that presented a single issue—whether, for FICA and FUTA tax purposes, the back wages paid by respondent are attributable to 1994, the year in which they were paid, or to 1986 and 1987, the years in which they would have been earned but for respondent's breach of the collective bargaining agreement. *Id.* at 4a, 6a, 9a.

---

[4] In this suit, respondent does not seek to recover the employee share of the FICA taxes. C.A. App. 7-18.

4. The government acknowledged in its brief to the district court that the prior decision of the Sixth Circuit in *Bowman* v. *United States*, 824 F.2d 528, 530 (1987), was controlling precedent on the issue in that court. In *Bowman*, the Sixth Circuit held that for FICA tax purposes, "[a] settlement for back wages should not be allocated to the period when the employer finally pays but should be allocated to the periods when the regular wages were not paid as usual." *Id.* at 530 (internal quotation marks and citation omitted). Because other circuits have disagreed with the reasoning and holding of *Bowman*, however, the government's brief explained to the district court that the government desired to preserve that issue for appeal. Pet. App. 10a. Acknowledging that "at least one court has disagreed with *Bowman*," the district court concluded that judgment in favor of the respondent was "dictated" by the Sixth Circuit precedent that was controlling in that court. *Id.* at 10a-11a.

5. The government appealed and filed a petition for hearing en banc in view of the circuit conflict. The court of appeals denied the petition and referred the case to a panel of the court. Pet. App. 4a.

The panel affirmed. Pet. App. 1a-5a. The panel noted that the government argued that the plain language of the FICA and FUTA statutes, the legislative history of those provisions, and the pertinent Treasury Regulations all demonstrate that *Bowman* was incorrectly decided and that "the government cites cases from our sister circuits that are at odds with our *Bowman* holding." *Id.* at 5a. The panel stated, however, that it was not required to address the merits of the government's contentions because, "[e]ven if we were persuaded by the government's argument, we are bound by the *Bowman* decision." *Ibid.*

SUMMARY OF ARGUMENT

1. Sections 3111(a) and (b) of the Internal Revenue Code impose the FICA taxes that fund Social Security and Medicare on "wages * * * paid" during the calendar year. Section 3301(a) similarly imposes the FUTA tax on "wages * * * paid * * * during the calendar year." No exception to this express statutory rule is created for back wages. Under the plain language of these statutes, back wages are taxed in the year in which they are paid and *not* in the year in which the services were performed or would have been performed but for the wrongful conduct of the employer.

The legislative history of the pertinent statutory provisions shows that Congress specifically intended wages to be taken into account in the year that they are paid, regardless of when earned or when owed by the employer. When Congress originally enacted these employment taxes in 1935, they were imposed "with respect to employment during the calendar year[]." Social Security Act, ch. 531, §§ 801, 804, 49 Stat. 636-637. In 1939, however, Congress amended the FICA and FUTA statutes to provide that the rate of tax would no longer be applied on the basis of when the services were performed but would instead be applied "[w]ith respect to wages received during the calendar year[]" in the case of the employee and "[w]ith respect to wages paid during the calendar year[]" in the case of the employer. Social Security Act Amendments of 1939, ch. 666, §§ 601, 604, 53 Stat. 1382-1383. Similarly, in 1946, a corresponding change was made to the provisions that place an annual ceiling on the amount of wages subject to FICA and FUTA tax to change the basis upon which the ceiling was measured from one that looked to services performed to one that looked at

wages paid during the year. Social Security Act Amendments of 1946, ch. 951, §§ 412(a), (b), 60 Stat. 989.

Consistent with the language of these statutes and their legislative history, Treasury Regulations have long specified that the relevant year for determining the FICA and FUTA taxes is the year in which the wages are paid or received. Applying the plain language of these statutes and regulations, the Treasury has consistently taken the position in its Revenue Rulings that back wages are to be taken into account for FICA and FUTA tax purposes in the year they are actually paid. Such "Treasury regulations and interpretations long continued without substantial change * * * are deemed to have received congressional approval and have the effect of law." *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 554, 561 (1991).

2. The decision in *Bowman* v. *United States*, 824 F.2d 528, 530 (6th Cir. 1987), upon which the court of appeals based its decision in this case, is fundamentally flawed. The *Bowman* court failed to address the plain text of the statute, and its clear legislative history, which demonstrates that Congress did not intend to allocate back wages to the year in which the services were performed. Instead, the court in *Bowman* based its holding that back wages are to be allocated to the year in which the services were performed solely on the theory that this result is required by this Court's decision in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946). In *Nierotko*, the issue was whether back pay awarded to an employee was to be treated, for benefit purposes, as "wages" under the original provisions of the Social Security Act of 1935 which defined that term as "remuneration * * * with respect to employment during any calendar year." Social Security

Act, ch. 531, § 210(a), 49 Stat. 625. See 327 U.S. at 360. The Court held in *Nierotko* that, for benefit computation purposes, back pay constitutes "wages" and should be allocated to "the periods when the regular wages were not paid as usual." 327 U.S. at 370.

In 1946, however, Congress amended the Social Security Act to change the annual "wage" ceiling for benefit computation purposes, just as it had done for the FICA and FUTA tax provisions. For "remuneration * * * with respect to employment * * * paid to an individual during any calendar year after 1946," the annual wage ceiling was to be based upon "remuneration * * * *paid* to such individual *during such calendar year*." Social Security Act Amendments of 1946, ch. 951, § 414(a)(3), 60 Stat. 991 (emphasis added). The statutory scheme considered in *Nierotko* thus obviously differed in this precise critical respect from the statutory provisions that have been in effect since 1946—the provisions that are involved in this case. Moreover, any suggestion that the statutory provisions that applied for benefit purposes in *Nierotko* should be applied for FUTA and FICA tax purposes in years following the 1946 amendments is contradicted by the decision of this Court in *Otte* v. *United States*, 419 U.S. 43 (1974). In *Otte*, the Court pointed out that, under the provisions that apply for years after 1946, "the tax is to be collected by the employer by deducting 'from the wages as and when paid.'" *Id.* at 51. As the Fourth Circuit concluded in *Hemelt* v. *United States*, 122 F.3d 204, 210 (1997), and the Tenth Circuit concluded in *Walker* v. *United States*, 202 F.3d 1290, 1292-1293 (2000), the court below erred in *Bowman* in relying on *Nierotko* and in refusing to consider the plain text and clear history of the applicable FICA and FUTA tax provisions.

ARGUMENT

FOR FICA AND FUTA TAX PURPOSES, AN AWARD OF BACK WAGES IS TO BE ATTRIBUTED TO THE YEAR IN WHICH THE AWARD IS ACTUALLY PAID, AND NOT TO THE YEAR OR YEARS IN WHICH THE EVENTS OCCURRED THAT GAVE RISE TO THE AWARD

A. The Plain Language Of The Relevant Statutes, Their Legislative History, And The Applicable Treasury Regulations Demonstrate That Back Wages Are To Be Attributed To The Year Of Payment For FICA And FUTA Tax Purposes

Under a settlement resolving player grievances, respondent paid back wages to its players in 1994 for services that were performed in 1986 and 1987. The court of appeals erred in holding that these back wages should be allocated for FICA and FUTA tax purposes to the years in which the wages were earned or should have been paid rather than to the year in which they actually were paid. Pet. App. 4a-5a.[5] Sections 3111(a)

---

[5] The statutory provisions involved in this case are set forth in the Federal Insurance Contributions Act (FICA), Chapter 21, Internal Revenue Code of 1986, 26 U.S.C. 3101-3128, and the Federal Unemployment Tax Act (FUTA), Chapter 23, Internal Revenue Code of 1986, 26 U.S.C. 3301-3311. These Acts serve to fund two major social initiatives that were enacted as part of the Social Security Act, ch. 531, 49 Stat. 620 (1935), as amended, 42 U.S.C. 301-1397jj. See generally, W. Cohen, *The Development of the Social Security Act of 1935: Reflections Some Fifty Years Later*, 6 Soc. Sec. Rep. Ser. 933, 933-934 (1984). The FICA tax funds the Federal Old Age, Survivors, Disability and Hospital Insurance Programs, commonly known as Social Security and

and (b) of the Internal Revenue Code impose the FICA taxes that fund Social Security and Medicare on "wages * * * paid" during the calendar year and Section 3301(a) imposes the FUTA tax on "wages * * * paid * * * during the calendar year." No exception to this express statutory rule is created for back wages. Under the plain language of these statutes, back wages are taxed in the year in which they are paid and not in the year in which the services were performed or would have been performed but for the wrongful conduct of the employer. The extensive legislative history of these provisions, and the consistent rulings and regulations of the Treasury, confirm that, under the plain text of these statutes, back wages must be attributed for FICA and FUTA purposes to the year in which the wages are actually paid.

Medicare. The FUTA tax funds a federal-state unemployment compensation program. *Ibid.*

The amount of wages that are subject to the FICA and FUTA taxes for a particular year are limited by statute. See 26 U.S.C. 3121(a)(1) (providing an annual ceiling on the "wages" subject to tax under Sections 3111(a) and 3101(a)); 26 U.S.C. 3306(b)(1) (providing an annual ceiling on the "wages" that are subject to tax under 26 U.S.C. 3301). The amount of wages subject to the FICA Medicare taxes imposed by 26 U.S.C. 3101(b) and 3111(b) was also limited for the years 1986 and 1987 (26 U.S.C. 3121(a)(1) (1982)), but there was no limit on the amount of "wages" used in computing the Medicare tax for 1994. 26 U.S.C. 3121(a)(1). The applicable rates of tax can also vary from year to year. See 26 U.S.C. 3101, 3111, 3301. Determining the proper year in which to attribute "wages" for FICA and FUTA tax purposes thus often has meaningful tax consequences.

1. ***The FICA Provisions***

a. Section 3101(a) of the Internal Revenue Code imposes the FICA tax on the wages received by an employee during the calendar year. It states (26 U.S.C. 3101(a) (emphasis added)):

> In addition to other taxes, there is hereby imposed on the income of every individual a tax equal to the following percentages of *the wages* (as defined in section 3121(a)) *received by him* with respect to employment (as defined in section 3121(b))—
>
> | In cases of *wages received during*: | The rate shall be: |
> |---|---|
> | 1984, 1985, 1986, or 1987 | 5.7 percent |
> | 1988 or 1989 | 6.06 percent |
> | 1990 or thereafter | 6.2 percent. |

Section 3111(a) similarly imposes the FICA tax on the wages paid by employers during the calendar year. It states (26 U.S.C. 3111(a) (emphasis added)):

> there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ, equal to the following percentages of *the wages* (as defined in section 3121(a)) *paid by him* with respect to employment (as defined in section 3121(b))—
>
> | In cases of *wages paid during*: | The rate shall be: |
> |---|---|
> | 1984, 1985, 1986, or 1987 | 5.7 percent |
> | 1988 or 1989 | 6.06 percent |
> | 1990 or thereafter | 6.2 percent. |

The provisions that impose the employee and employer Medicare taxes (26 U.S.C. 3101(b), 3111(b)) are similarly worded and also apply to "wages received during" and "wages paid during" the relevant tax year. In

addition, pursuant to 26 U.S.C. 3102(a), the employer is to deduct the employee's portion of the FICA tax "from the wages as and when paid." Under the plain text of these provisions, (i) the FICA tax is determined by applying the rate in effect during the year to the wages paid or received during that year and (ii) the amount of tax thus determined is to be deducted from the employee's wages in the year the wages are paid.

Section 3121(a)(1) imposes the annual ceiling on the amount of wages to which the FICA tax applies. That ceiling also explicitly applies to the year that the wages are paid and not to the year of employment. It specifies that "wages" for purposes of 26 U.S.C. 3101(a) and 3111(a) do not include (26 U.S.C. 3121(a)(1) (emphasis added)):[6]

> *that part of the remuneration* which, *after remuneration* (other than remuneration referred to in the succeeding paragraphs of this subsection) *equal to the contribution and benefit base* (as determined under section 230 of the Social Security Act) with respect to employment *has been paid* to an individual by an employer *during the calendar year* with respect to which such contribution and benefit base is effective, is paid to such individual by such employer during such calendar year.

b. The legislative history of these FICA provisions shows that Congress specifically intended wages to be taken into account in the year that they are paid, regardless of when earned or when owed by the employer. As originally enacted in 1935, the Social Security Act provided that FICA tax rates, which

[6] Similarly, 26 U.S.C. 6413(c)(1) provides a credit for excess FICA taxes paid on the "wages received" by an employee.

gradually increased over the period from 1937 through 1948, applied "with respect to employment during the calendar year[]." Social Security Act of 1935, ch. 531, §§ 801, 804, 49 Stat. 636-637. Interpreting this language from the 1935 Act, the original Treasury regulations specified that "[t]he employees' tax is computed by applying to the wages received by the employee *the rate in effect at the time of the performance of the services* for which the wages were received" (Treas. Reg. 91, Art. 202 (1936) (emphasis added)) and that "[t]he employers' tax is computed by applying to the wages paid by the employer *the rate in effect at the time of the performance of the services* for which the wages were paid" (Treas. Reg. 91, Art. 302 (1936) (emphasis added)).

In 1939, however, Congress amended FICA expressly to provide that the tax would no longer be applied on the basis of when the services were performed but would instead be applied "[w]ith respect to wages *received* during the calendar year[]" in the case of the employee and "[w]ith respect to wages *paid* during the calendar year[]" in the case of the employer. Social Security Act Amendments of 1939, ch. 666, §§ 601, 604, 53 Stat. 1382-1383 (emphasis added). The Report of the Committee on Ways and Means explained this change as follows:

> A further change is made by this amendment. *Sections 1400 and 1410 of the Internal Revenue Code [the predecessors of 26 U.S.C. 3101 and 3111] now provide that the rate of tax applicable to wages is the rate in effect at the time of the performance of the services for which the wages are paid.* This will unnecessarily complicate the making of returns and the collection of the taxes in later years when the

rate of tax has been increased. For example, in 1943 the rate of tax increases from 1 percent to 2 percent. Thus, wages which are paid in 1943 for services performed in 1942 will be subject to the 1-percent rate, while wages paid in 1943 for services performed in that year will be subject to the 2-percent rate. Provision must therefore be made in the return for 1943 for the reporting of wages subject to the different rates, and, in auditing the returns, it will be necessary to ascertain not merely the time when the wages were paid and received, but also the year of the rendition of the services for which the wages are paid. If employers have failed to make the proper distinction, many refunds and additional assessments will doubtless be necessary and confusion will result. *Under the amendment the rate applicable would be the rate in effect at the time that the wages are paid and received without reference to the rate which was in effect at the time the services were performed.*

H.R. Rep. No. 728, 76th Cong., 1st Sess. 57-58 (1939) (emphasis added). See also S. Rep. No. 734, 76th Cong., 1st Sess. 70-71 (1939).[7]

The legislative history of the parallel changes in the provisions that establish the annual ceiling on wages subject to the FICA tax (currently in 26 U.S.C.

[7] In enacting this new rule, Congress emphasized that, "[w]ith both the old-age-insurance tax [FICA] and the unemployment-compensation tax [FUTA] on the wages paid basis, the keeping of records by employers will be simplified." S. Rep. No. 734, *supra*, at 76; H.R. Rep. No. 728, *supra*, at 62-63. Following enactment of these amendments, the relevant Treasury Regulations were rewritten to reflect this change in the statute. See Treas. Reg. 106 §§ 402.302, 402.402 (1940); page 19 & note 10, *infra*.

3121(a)(1)) also reflects the clear intent of Congress that the FICA taxes are to be determined on a wages-paid basis.[8] As originally enacted in 1935, the Social Security Act allocated wages to the year in which services were performed in applying the annual FICA tax wage ceiling. Social Security Act of 1935, ch. 531, § 811(a), 49 Stat. 639. In 1946, Congress amended that annual ceiling provision to change the basis upon which the ceiling is measured from services performed during the year to wages paid during the year.[9] Social Security Act Amendments of 1946, ch. 951, § 412(a), 60 Stat. 989. The reports of the Senate Finance Committee and the House Committee on Ways and Means explained that, "[u]nder the definition of the term contained in existing law there is excluded from 'wages', for [FICA and FUTA tax] purposes, all remuneration with respect to employment during any calendar year paid to an individual by an employer (irrespective of the year of payment) after

[8] When Congress has determined that a particular type of wages should be excepted from the general rule that attributes them to the year in which they are paid or received, it has done so by special rule. Congress created a special timing rule for compensation attributable to certain nonqualified deferred compensation plans in 26 U.S.C. 3121(v)(2) and 3306(r)(2). Under that special rule, this specific type of compensation is "taken into account for purposes of this chapter as of the later of * * * when the services are performed, or * * * when there is no substantial risk of forfeiture of the rights to such amount." 26 U.S.C. 3121(v)(2). No similar special timing rule for "back wages" has been enacted by Congress.

[9] Subsequent to the enactment of the Social Security Act of 1935, Congress enacted the Internal Revenue Code of 1939 and incorporated the FICA tax provisions in it. The annual wage ceiling provision was designated as Code Section 1426(a)(1). 26 U.S.C. 1426(a)(1) (1940).

remuneration equal to $3,000 has been paid to such individual by such employer with respect to employment during such year." S. Rep. No. 1862, 79th Cong., 2d Sess. 35 (1946); H.R. Rep. No. 2447, 79th Cong., 2d Sess. 35 (1946). These reports explained that the new legislation "amends such definitions, effective January 1, 1947, to constitute as the yardstick *the amount paid during the calendar year* (with respect to employment to which the taxes under the code are applicable), *without regard to the year in which the employment occurred.*" S. Rep. No. 1862, *supra*, at 35 (emphasis added); H.R. Rep. No. 2447, *supra*, at 35 (emphasis added). These reports concluded that, "in applying the $3,000 limitation on wages, *the employer, employee, and those administering the taxes, may, beginning with the calendar year 1947, look only to the amount of remuneration paid* by the employer to the employee *during the calendar year*, and exclude all remuneration paid during the calendar year after $3,000 has been paid during the year with respect to * * * the employment with respect to which the taxes imposed by * * * the Federal Insurance Contributions Act are applicable[]." S. Rep. No. 1862, *supra*, at 36 (emphasis added); H.R. Rep. No. 2447, *supra*, at 35 (emphasis added).

After these various amendments were enacted in 1939 and 1946, the FICA and FUTA tax provisions were recodified in the Internal Revenue Code of 1954 and given their current section numbers. "No substantive changes," however, were made in these provisions. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A324 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 482 (1954). Although the applicable tax rates and the amounts of the annual wage ceilings have scaled upward since the enactment of the 1954 Code, the FICA and FUTA provisions involved in this case have remained substantially the same since 1946. See 26 U.S.C. 3101, 3111, 3121(a).

c. In accordance with the language of the amended statutes and their legislative history, Treasury regulations have consistently specified that the relevant year for determining the FICA tax is the year in which the wages are paid or received.[10] These regulations expressly provide that "[t]he employee tax attaches at the time that the wages are received by the employee" (26 C.F.R. 31.3101-3) and that "[t]he employee tax is computed by applying to the wages received by the employee the rate in effect at the time such wages are received" rather than during "the year in which the services were performed" (26 C.F.R. 31.3101-2(c) & Example). The regulations further specify that "[t]he employer tax attaches at the time that the wages are paid by the employer" (26 C.F.R. 31.3111-3) and that "[t]he employer tax is computed by applying to the wages paid by the employer the rate in effect at the time such wages are paid" (26 C.F.R. 31.3111-2(c)).[11] The regulations that interpret the statutory annual

---

[10] In 1960, the Treasury Regulations governing FICA and FUTA were consolidated and republished with their current section numbers. T.D. 6516, 25 Fed. Reg. 13,032 (Dec. 20, 1960). The substance of these regulations traces back to earlier promulgations. See Treas. Reg. 107 (as amended by T.D. 5566, 1947-2 C.B. 148); Treas. Reg. 106 (as amended by T.D. 5566, 1947-2 C.B. 148); Treas. Reg. 106 (1940), §§ 402.301, 402.302, 402.303, 402.401, 402.402, 402.403.

[11] These regulations further provide that, "[i]n general, wages are received by an employee at the time that they are paid by the employer to the employee. Wages are paid by an employer at the time that they are actually or constructively paid unless under paragraph (c) of this section [which concerns specified types of minor cash payments that are not involved in this case] they are deemed to be subsequently paid." 26 C.F.R. 31.3121(a)-2(a).

ceiling on the amount of wages subject to the FICA tax (26 U.S.C. 3121(a)(1) further provide that this limitation "relates to the *amount of remuneration received during any 1 calendar year* for employment after 1946 *and not to the amount of remuneration for employment performed* in any 1 calendar year." 26 C.F.R. 31.3121(a)(1)-1(a)(2) (emphasis added). In numerous Revenue Rulings that have been issued to apply these statutes and regulations in specific contexts, the Treasury has consistently concluded that back wages are to be taken into account for FICA purposes in the year that they are actually paid, regardless of when earned or owed. Rev. Rul. 55-203, 1955-1 C.B. 114, 115; Rev. Rul. 89-35, 1989-1 C.B. 280; see also Rev. Rul. 78-336, 1978-2 C.B. 255; Rev. Rul. 1957-92, 1957-1 C.B. 306, 307.

It is well established that "Treasury regulations and interpretations long continued without substantial change, applying to unamended or substantially reenacted statutes, are deemed to have received congressional approval and have the effect of law." *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 561 (1991) (internal quotation marks and citations omitted); see also *Atlantic Mutual Ins. Co.* v. *Commissioner*, 523 U.S. 382, 389 (1998). This Court has made clear that "[t]he role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner." *United States* v. *Correll*, 389 U.S. 299, 307 (1967). See also *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979). "Because the rule challenged here has not been shown deficient on that score, the Court of Appeals should have sustained its validity." *United States* v. *Correll*, 389 U.S. at 307.

2. *The FUTA Provisions*

a. The text, history, and administrative interpretation of the FUTA tax provisions parallels that of the FICA provisions just described. Section 3301 of the Internal Revenue Code imposes the FUTA tax on the wages paid by an employer during the calendar year. It states (26 U.S.C. 3301 (emphasis added)):

> There is hereby imposed on every employer (as defined in section 3306(a)) for each calendar year an excise tax, with respect to having individuals in his employ, equal to—
>
> (1) 6.2 percent in the case of calendar years 1988 through 2007; or
>
> (2) 6.0 percent in the case of calendar year 2008 and each calendar year thereafter;
>
> of the total *wages* (as defined in section 3306(b)) *paid by him during the calendar year* with respect to employment (as defined in section 3306(c)).

Section 3306(b)(1) imposes the annual ceiling on the amount of wages to which the FUTA tax applies. That ceiling also explicitly applies to the year that the wages are paid and not to the year of employment. It specifies that "wages" for purposes of 26 U.S.C. 3301 do not include (26 U.S.C. 3306(b)(1) (emphasis added)):

> *that part of the remuneration* which, *after remuneration* (other than remuneration referred to in the succeeding paragraphs of this subsection) *equal to $7,000 with respect to employment has been paid to an individual by an employer during any calendar year*, is paid to such individual by such employer during such calendar year.

Thus, as with the FICA provisions, the plain language of the FUTA provisions imposes the tax in the year in which the wages are paid or received, and does not allocate wages to the year in which the services generating the wages were performed.

b. The legislative history of the FUTA provisions also demonstrates that Congress expressly intended wages to be taken into account in the year that they are paid, regardless of when earned or when owed by the employer. As originally enacted in 1935, the Social Security Act provided that FUTA tax rates, which gradually increased from 1 percent to 3 percent over the period from 1936 through 1938, applied "[w]ith respect to employment during the calendar year." Social Security Act, ch. 531, § 901, 49 Stat. 639. In 1939, however, Congress amended the FUTA tax provisions (in the same manner that it amended the FICA provisions) to provide that the rate of tax would no longer be applied with respect to "employment during the calendar year" but would instead be applied to "wages * * * paid by [an employer] during the calendar year * * * *." Social Security Act Amendments of 1939, ch. 666, § 608, 53 Stat. 1387. The reports of the Senate Finance Committee and the House Committee on Ways and Means explained that this 1939 amendment was adopted to make the FUTA tax applicable to "wages paid" rather than "wages payable" and thus paralleled the change made at the same time to the FICA tax which, under the 1939 amendments, "also imposes a tax on 'wages paid.'" S. Rep. No. 734, *supra*, at 75; H.R. Rep. No. 728, *supra*, at 62. These reports explain that (S. Rep. No. 734, *supra*, at 75-76 (emphasis added)):

> *Under the existing law* wages are "payable" with respect to employment during a calendar year, even though the amount of wages is not fixed and no right exists to enforce payment at any time during that year. Thus *a bonus paid in 1939 for services performed in 1938 constitutes "wages payable" for 1938, even though the amount of the bonus may not have been known in 1938 and no obligation to pay it existed in that year.*
>
> In cases in which remuneration for services of an employee in a particular year is based on a percentage of profits, or on future royalties, the amount of which cannot be determined until long after the close of the year, the employer has been required to estimate unascertained amounts and pay taxes and contributions on that basis. If he has overestimated, subsequent corrections on the return must be made with consequent refunds. If the employer has underestimated, additional taxes may become due and he may also be compelled to pay additional State contributions, which are usually not allowable as credit because not timely paid. *The attendant difficulties and confusion cause a burden on employers and administrative authorities alike. The placing of this tax on the "wages paid" basis will relieve this situation.*
>
> *With both the old-age-insurance tax [FICA] and the unemployment-compensation tax [FUTA] on the wages paid basis, the keeping of records by employers will be simplified.*

The legislative history of the wage ceiling that applies to the FUTA tax (currently codified at 26 U.S.C. 3306(b)(1)) further confirms that this tax is to be

calculated and determined on a wages-paid basis. As originally enacted in 1935, the Social Security Act placed no ceiling on the wages subject to this tax. Social Security Act of 1935, ch. 531, §§ 901, 907(b), 49 Stat. 639-642. In 1939, however, Congress amended the definition of wages for FUTA purposes to impose an annual ceiling that tracked the annual wage ceiling applicable under the FICA—which at that time measured the ceiling by the wages for services performed in the calendar year. See page 17, *supra*. When Congress amended the annual wage ceiling on the FICA tax in 1946 to place it on a wages-paid basis (see *ibid.*), Congress made a parallel amendment to the FUTA wage ceiling "to effect a corresponding change." S. Rep. No. 1862, *supra*, at 36; H.R. Rep. No. 2447, *supra*, at 35; see Social Security Act Amendments of 1946, ch. 951, § 412(b), 60 Stat. 989 (amending the FUTA wage ceiling).

c. The Treasury regulations interpreting FUTA have long specified that this tax is to be determined by allocating wages to the year in which they are paid, regardless when those wages were earned or were owed by the employer. These regulations specify that "[t]he tax for any calendar year is measured by the amount of wages paid by the employer during such year" (26 C.F.R. 31.3301-2) and that "[t]he tax is computed by applying to the wages paid in a calendar year * * * the rate in effect at the time the wages are paid" (26 C.F.R. 31.3301-3(b)). The regulations that interpret the statutory annual ceiling on wages subject to FUTA (26 U.S.C. 3306(b)(1)) also expressly provide that the ceiling applies "to the *amount of remuneration paid during any one calendar year* for employment after 1938, *and not to the amount of remuneration for employment performed in any one calendar year.*"

26 C.F.R. 31.3306(b)(1)-1(a)(2) (emphasis added).[12] Because these regulations conform to the plain text and history of these statutes, and thus undoubtedly "implement the congressional mandate in some reasonable manner," the agency's interpretation should have been sustained by the court of appeals. *United States* v. *Correll*, 389 U.S. at 307.

B. The Bowman Case, On Which The Court Of Appeals Based Its Decision, Was Wrongly Decided

In the present case, the court of appeals did not consider or address the agency's consistent interpretation of these controlling statutory provisions. Nor did the court provide any analysis or discussion of the text of the statutes or their legislative history. Instead, the Sixth Circuit rejected the government's position solely on the basis of that court's prior decision in *Bowman*. Pet. App. 5a. In *Bowman*, however, the court had *also* failed to address the clear statutory text and legislative history that demonstrates that, after 1946, Congress did not intend to allocate wages to the year in which services were performed. The court in *Bowman* also failed to address or consider the deference due to the

---

[12] These regulations state that, in applying the annual ceiling, "the term 'wages' does not include that part of the remuneration paid within any calendar year by an employer to an employee which exceeds the first $3,000 of remuneration * * * paid within such calendar year by such employer to such employee for employment performed for him at any time after 1938." 26 C.F.R. 31.3306(b)(1)-1(a)(1). Since these regulations were issued, the annual wage ceiling has been raised by statute to $7,000. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 271(a), 96 Stat. 554; Unemployment Compensation Amendments of 1976, Pub. L. No. 94-566, § 211(a), 90 Stat. 2676; Employment Security Amendments of 1970, Pub. L. No. 91-373, § 302, 84 Stat. 713.

interpretation of these statutes set forth in the consistent and longstanding Treasury regulations. Instead, in *Bowman*, the court of appeals based its holding that back wages are to be allocated to the years in which services were performed, rather than to the year in which the back wages were paid, solely on the theory that that result is required by the decision of this Court in *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946). See 824 F.2d at 530. The decision in *Nierotko*, however, does not support the erroneous holding of the court of appeals.

1. The *Nierotko* case involved an application of the Social Security Act provisions that predated the changes made to these statutes by Congress in 1946. In *Nierotko*, an employee was awarded "back pay" under the National Labor Relations Act for the period from February 2, 1937, to September 25, 1939, for being wrongfully discharged due to his union activities. The back pay was paid on July 18, 1941. The principal issue for decision was whether that back pay was to be treated as "wages" in determining the employee's entitlement to benefits under the Social Security Act of 1935.[13] The Court first concluded that back pay constitutes "wages" for purposes of the Act. 327 U.S. at 360-370. The Court then stated that, "[i]f, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods

[13] The definition of "wages" for benefit purposes that was at issue in *Nierotko* appeared in Title II of the Social Security Act of 1935. Social Security Act of 1935, ch. 531, § 210(a), 49 Stat. 625. This provision mirrored the definition of "wages" for Social Security tax purposes which appeared in Title VIII of the 1935 Act. Social Security Act of 1935, ch. 531, § 811(a), 49 Stat. 639.

when the regular wages were not paid as usual." *Id.* at 370.

The *Nierotko* case was decided under the original provisions of the Social Security Act of 1935 that defined "wages" as "remuneration for employment," subject to a $3,000 wage ceiling "with respect to employment during any calendar year."[14] Social Security Act, ch. 531, § 210(a), 49 Stat. 625. See 327 U.S. at 360. The term "employment" was further defined in that Act as "any service * * * performed * * * by an employee for his employer." Social Security Act, ch. 531, § 210(b), 49 Stat. 625. The statute applied in *Nierotko* thus used services performed, rather than payments received, to define the annual wage ceiling for benefit purposes. See page 17, *supra*.

In 1946, Congress amended the Social Security Act to change the annual "wage" ceiling for the FICA and FUTA tax provisions and for benefit purposes as well. Under the new statute, for "remuneration * * * with respect to employment * * * paid to an individual during any calendar year *after 1946*," the annual ceiling was based upon "remuneration * * * *paid* to such individual during such calendar year." Social Security Act Amendments of 1946, ch. 951, § 414(a)(3), 60 Stat. 991 (emphasis added). The legislative reports for the 1946 Act plainly state that the annual wage ceiling for benefit computation purposes (and for FICA and FUTA tax purposes) was thereafter to be determined based upon the date of the wage payment and "without

[14] The Court expressly held that Title II of the Social Security Act, ch. 531, 49 Stat. 622, and *not* Title II of the Social Security Act Amendments of 1939, ch. 666, 53 Stat. 1362 (42 U.S.C. 401 *et seq.*), effective January 1, 1940, governed the benefit issues before it. 370 U.S. at 360.

regard to the year in which the employment occurred." S. Rep. No. 1862, *supra*, at 35; H.R. Rep. No. 2447, *supra*, at 35. See also page 18, *supra*. The statutory scheme considered in *Nierotko* thus obviously differed in this precise critical respect from the statutory provisions that have been in effect since 1946—the provisions that are involved in this case.[15]

2. Moreover, as the Sixth Circuit acknowledged in the *Bowman* case, the decision in *Nierotko* "is factually distinguishable from the present case" because it "involved back wages in the benefits context as opposed to the taxation context." 824 F.2d at 530; see also *Mazur* v. *Commissioner*, 986 F. Supp. 752, 755-756 (W.D.N.Y. 1997). The considerations relevant for benefit purposes are not necessarily the same as those for tax purposes. As this Court observed in *Flemming* v. *Nestor*, 363 U.S. 603, 609 (1960), "eligibility for benefits, and the amount of such benefits, do not in any true sense depend on contribution to the program through the

[15] In a program policy statement, the Social Security Administration (SSA) has indicated that, for benefit computation purposes, it will continue to apply the *Nierotko* rule to one particular type of back wages—"back pay under a statute." SSA, Dep't of Health & Human Servs., SSR 83-7, 1981-1991 Soc. Sec. Rep. Ser. 18 (1983); see also 20 C.F.R. 404.1242(b). This policy statement applies only for benefit computation purposes; it does not apply for tax purposes. SSA, Dep't of Health & Human Servs., *Reporting Back Pay and Special Wage Payments to the Soc. Sec. Admin.*, Pub. No. 957 (Sept. 1997), at 1 ("The Social Security Administration (SSA) has special rules for back pay * * * for social security coverage and benefit purposes only."). Indeed, the SSA has noted that, under the rule that applies for tax purposes under the Social Security Act, "employers are liable for Federal Insurance Contributions Act tax payments on back pay on the basis of when the payment is made * * *." SSR 83-7, *supra*, at 19. Accord, Pub. No. 957, *supra*, at 2.

payment of taxes, but rather on the earnings record of the primary beneficiary." See also *Walker* v. *United States*, 202 F.3d 1290, 1293 (10th Cir. 2000) ("The Social Security Administration is a different agency, implementing a different statutory scheme."); note 15, *supra*. In determining an employee's eligibility for benefits, and the amount thereof, an allocation of an award of back wages to the periods of employment to which such back wages relate may be consistent with the policy of providing security to employees in retirement. Absent such an allocation, an employee may not obtain credit for a sufficient number of quarters to allow him to collect benefits and the amount of benefits awarded may similarly be affected.

No similar policy considerations are at stake in the tax context. Indeed, taxing back wages in the year actually paid does not routinely result in additional FICA and FUTA tax liability, even though it appears to do so in this particular case. To the contrary, in the common situation in which, during the year of payment (as opposed to the year to which such back wages could be attributed), the employee had already reached the maximum wage limit, *less* tax would be owed when the back wages are taxed in the year paid. As one commentator has pointed out, "[t]he *Bowman* case will seldom provide an advantageous result for current [taxpayers]." K. Gideon, *Lawsuits and Settlements* § 1101.4, at 262 (1995). Instead, it is "expensive for most taxpayers." *Id.* at 263 n.42.

Moreover, because of the complexities of restating tax liabilities for cash-basis taxpayers from the year of payment to former periods of time, the rule adopted in *Bowman* would "impose[] substantial administrative burdens" both on taxpayers and on the IRS. K. Gideon, *supra*, at 263 n.42. In particular, imposing these taxes

in the year the services were performed, rather than the year the wages were paid, would destroy symmetry between the collection of income taxes and FICA taxes on wages. Under the federal income tax (26 U.S.C. 1), "payments of compensation are income to a taxpayer on a cash basis in the year of receipt, as distinguished from the year in which the compensation is earned." *In re Freedomland, Inc.*, 480 F.2d 184 (2d Cir. 1973), aff'd *sub nom. Otte v. United States*, 419 U.S. 43 (1974). An employee who receives an award of back wages is, for purposes of the income tax, to include those wages in the year in which they are paid. The employer is also to withhold the resulting income taxes in that year. Under the rule adopted in the *Bowman* case, however, the employer would be required to withhold Social Security and Medicare taxes in the year the services were performed rather than in the year the wages were actually paid. The existence of two inconsistent withholding requirements for income and FICA taxes owed on the same wages would obviously create "difficulties and confusion" for "employers and administrative authorities alike." S. Rep. No. 734 , *supra*, at 76; H.R. Rep. No. 728, *supra*, at 62. It was expressly to "relieve" such "difficulties and confusion" that Congress amended these statutes in 1939 to place the FUTA and FICA taxes "on the 'wages paid' basis." S. Rep. No. 734, *supra*, at 75; H.R. Rep. No. 728, *supra*, at 63.[16] See pages 18, 23, *supra*.

[16] The Internal Revenue Code contemplates that there will be some common administration of the income tax and the employment tax. For example, if an employee receives wages from more than one employer, the wages on which the employee pays FICA taxes through withholding by his employers may exceed the contribution and benefit base for a particular year (*i.e.*, the annual wage ceiling). Under 26 U.S.C. 6413(c)(1), the employee would ordinarily receive a credit or refund of the tax to the extent that the tax exceeds the tax computed on the amount of a single annual wage ceiling. This credit or refund, however, is "subject to the provisions of section 31(b)." 26 U.S.C. 6413(c)(1). And, under 26 U.S.C. 31(b), the Secretary of the Treasury is authorized to apply an employment tax credit against the employee's income tax.

3. The suggestion in *Bowman* that the rule applied in *Nierotko* for benefit purposes under the *pre*-1946 statutory scheme governs this *post*-1946 tax case is contradicted by this Court's decision in *Otte* v. *United States*, 419 U.S. 43 (1974), aff'g *In re Freedomland, Inc.*, 480 F.2d 184 (2d Cir. 1973). In *Otte*, former employees of a bankrupt corporation filed wage claims for services performed prior to the filing of the bankruptcy petition. The district court held that the bankruptcy trustee was required to withhold federal income and employment taxes with respect to such claims. 419 U.S. at 46. The district court also held that the government was not required to file a proof of claim to recover the withheld taxes and that the government claim should be given fourth priority. *Id.* at 46-47. The court of appeals affirmed these holdings and rejected the trustee's assertion that requiring the trustee to withhold taxes would create an administrative "parade of horribles." 480 F.2d at 188. The court of appeals pointed out that most wage earners are on a cash basis and report their income taxes when their wages are received and that the "[w]ithholding of social security taxes is also done 'by deducting the amount of the tax from the wages *as and when paid*.'" *Id.* at 189 n.8 (quoting 26 U.S.C. 3102(a)). The court further noted that "[t]he taxes are by law calculable only when the wage claims are paid and not until then." *Id.* at 190. The court of appeals thus recognized that back pay is taken into account for FICA tax purposes in the year

the payment is received, rather than the year for which the payment was owed.

This Court affirmed. 419 U.S. at 58. The Court first concluded that, although "the payments to the wage claimants who filed in this case [were] * * * made after the employment relationship terminated," they were still "wages" for purposes of income tax withholding and that "the situation is the same with respect to FICA withholding." *Id.* at 49, 51. The Court then observed that "Section 3102(a) of the Internal Revenue Code, 26 U.S.C. § 3102(a), provides that the tax is to be collected by the employer by deducting 'from the wages as and when paid.'" 419 U.S. at 51. The Court therefore concluded that "the payments clearly are 'wages' under that statute, even though again, at the time of payment, the employment relationship between the bankrupt and the claimant no longer exists." *Ibid.* The Court stated that this conclusion was also supported by the longstanding regulations that "consistently have been to this effect." *Ibid.* The Court emphasized that the payments became subject to FICA tax when paid, rather than when earned, for "[l]iability for the taxes accrues only when the wage is paid." *Id.* at 55 (citing 26 U.S.C. 3402(a) and 3101(a)). The Court explained that "[t]he wages that are the subject of the wage claims, although earned before bankruptcy, were not paid prior to bankruptcy. Freedomland [the debtor] had incurred no liability for the taxes. Liability came into being only during bankruptcy. The taxes do not partake, therefore, of the nature of debts of the bankrupt for which proofs of claim must be filed." 419 U.S. at 55. In *Otte*, the Court thus expressly concluded that, under the plain text of these statutes, FICA tax liability arises at the time that the back wages are paid, rather than at

the time the work to which the wage claim relates is performed.

4. The reasoning of the court of appeals in *Bowman* has been expressly rejected by the two courts of appeals that have considered it.[17] In *Hemelt* v. *United States*, 122 F.3d 204 (4th Cir. 1997), the taxpayers had received a payment in settlement of a class action suit brought under Section 502 of the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 891. The ERISA suit had alleged that the taxpayers' employer had improperly fired them to prevent them from qualifying for pension benefits. The taxpayers contended that the settlement payment did not represent "wages" subject to the FICA tax and further contended, relying on the Sixth Circuit's decision in *Bowman* (Appellant's Br. 46), that, even if the payment constituted "wages," it must be allocated to the years the wages would have been earned (but for the improper termination) instead of to the year the payment was received. 122 F.3d at 210. The Fourth Circuit first concluded that the settlement payment represented back pay for a wrongful termination of employment and

---

[17] In *Johnston* v. *Harris County Flood Control District*, 869 F.2d 1565 (1989), the Fifth Circuit cited *Bowman* for the proposition that "[a]t least for purposes of FICA (Social Security) taxes, a plaintiff receiving a back pay award is liable for the taxes that would have accrued in the year the wages were due." *Id.* at 1580. The *Johnston* case, however, was not a tax case. The question whether the award would be subject to tax was relevant in that case *only* for the purpose of determining the proper amount of such an award. *Ibid.* For that purpose, the *timing* of the tax was not material. Instead, what was material was simply whether the backpay award would be taxable or "tax-free"—for only an "award that accounts for the plaintiff's tax liability accurately reflects the amount that the plaintiff actually lost." *Ibid.*

therefore constituted "wages" for purposes of the FICA tax. *Id.* at 209-210. The court then held that the taxpayer's reliance on the *Bowman* decision was "meritless." *Id.* at 210. Without discussing the *Bowman* opinion directly, the court rejected the reasoning of that decision because "[i]t is clear under the Treasury Regulations that 'wages' are to be taxed for FICA purposes in the year in which they are received." *Ibid.* (citing 26 C.F.R. 31.3121(a)- 2(a)).[18]

In *Walker* v. *United States*, 202 F.3d 1290 (2000), the Tenth Circuit has also rejected the analysis and conclusion of the *Bowman* decision. In that case, in the years 1992 through 1995, a lawyer received a portion of a contingency fee payment owed in connection with an antitrust lawsuit that had been filed in 1972 and settled in 1975. The lawyer paid Self-Employment Contributions Act (SECA) taxes imposed by 26 U.S.C. 1401 on the amounts received. He then brought a refund suit, claiming that the amounts received during the years 1992 through 1995 should be allocated to the years in which the services were performed (1971 through 1975). In urging that claim, he relied on the decision of this Court in *Nierotko* and the decision of the Sixth Circuit in *Bowman*. The Tenth Circuit found the decision in *Nierotko* "inapposite" and the decision in *Bowman* "unpersuasive," 202 F.3d at 1293. The Tenth Circuit, like the Fourth Circuit in *Hemelt*, relied significantly on the fact that the governing Treasury Regulations

[18] The court of appeals noted in the *Hemelt* case that the taxpayers had provided no evidence of how the court should "allocate their awards among the years to which they [were] supposedly attributable" and that, as a consequence, the court "could not undertake such allocation even if [it] were allowed to do so." 122 F.3d at 210-211.

specify that wages are subject to tax when they are received, not when the services are rendered. *Id.* at 1292-1293.

5. The court of appeals thus erred in *Bowman* in failing to consider the plain language of the pertinent statutes, their legislative history, and the applicable Treasury Regulations—all of which establish that back wages are to be taken into account for FICA and FUTA tax purposes in the year actually paid, regardless of when the services were performed. The court of appeals should have been guided by this Court's decision in *Otte*, which applied the relevant statutory provisions, rather than this Court's decision in *Nierotko*, which applied statutory provisions that no longer exist and which have been amended by the provisions that are controlling in this case. See pages 31-33, *supra*.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

SETH P. WAXMAN
Solicitor General
PAULA M. JUNGHANS
Acting Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
KENNETH L. GREENE
ROBERT W. METZLER
Attorneys

NOVEMBER 2000

JAN 16 2001

Supreme Court, U.S.
FILED
JAN 16 2001
OFFICE OF THE CLERK

No. 00-203

IN THE
Supreme Court of the United States

UNITED STATES OF AMERICA,

Petitioner,

v.

CLEVELAND INDIANS BASEBALL COMPANY, A LIMITED PARTNERSHIP,

Respondent.

On Writ of Certiorari To The United States Court of Appeals for the Sixth Circuit

BRIEF FOR RESPONDENT

G. MICHAEL HALFENGER
ANNE BERLEMAN KEARNEY
FOLEY & LARDNER
777 E. Wisconsin Avenue
Milwaukee, Wis. 53202
(414) 297-5555

CARTER G. PHILLIPS*
RICHARD D. BERNSTEIN
JOHN F. WESTER
STEPHEN B. KINNAIRD
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 736-8000

Counsel for Respondent

* Counsel of Record

January 16, 2001

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether the rule that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual," *Social Security Board* v. *Nierotko*, 327 U.S. 358, 370 (1946), should apply to both the tax and benefits titles of the Social Security Act, when there is no difference in statutory language and the structure, history, and policy of the Act require symmetry between taxation and benefits?

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	v
STATEMENT OF THE CASE	1
SUMMARY OF ARGUMENT	6
ARGUMENT	10
I. THE GOVERNMENT'S LEGAL ARGUMENT CONFLICTS WITH THE PLAIN MEANING AND PURPOSES OF THE STATUTES	12
A. The Social Security Acts Of 1935 And 1939	12
1. Social Security Act of 1935	12
2. Social Security Act Amendments of 1939	13
B. Applying The "Wages Paid" Language Of The 1939 Act, *Nierotko* Held That Back Pay "Wages" Are Deemed "Paid" In The Year In Which They Would Have Been Paid But For The Wrongful Conduct	16
C. The Government's Argument That *Nierotko* Was Undermined By The 1946 Act Is Based On Its Misunderstanding Of This Court's Decision	20
D. The Government's Argument That The Tax And Benefits Titles Are Not To Be Construed *In Pari Materia* Is Contrary To The Act's Structure And History And The Government's Prior Arguments To This Court	22
E. The *Nierotko* Rule Does Not Resurrect The "Wages Payable" Rule Abandoned In The 1939 Act	26

TABLE OF CONTENTS – continued

	Page
II. THE GOVERNMENT'S RULE IS INCONSISTENT WITH THE PLAIN LANGUAGE OF THE STATUTE AS A WHOLE AND ITS PURPOSES	31
A. The Government's Rule Is Inconsistent With The Rational Operation Of Other Statutory Provisions	31
1. Definition of Taxable "Wages"	32
2. Definition of Taxable "Employment"	35
3. Definition of Taxable "Employer"	37
B. The Government's Rule Is Inconsistent With The Nature Of FICA And FUTA As Excise Taxes On The Employment Relation	39
C. The Interpretation Of An Employer's Withholding Obligations In *Otte* Is Immaterial To The Calculation Of The Tax Owed	45
III. THE GOVERNMENT'S INTERPRETATION IS NOT ENTITLED TO DEFERENCE	48
CONCLUSION	50

TABLE OF AUTHORITIES

CASES

	Page
Bailey v. *United States*, 516 U.S. 137 (1995)	31
Bartels v. *Birmingham*, 332 U.S. 126 (1947)	49
Beecham v. *United States*, 511 U.S. 368 (1994)	8
Bowman v. *United States*, 824 F.2d 528 (6th Cir. 1987)	4, 11, 22
California v. *FERC*, 495 U.S. 490 (1990)	30
Cannon v. *University of Chicago*, 441 U.S. 677 (1979)	7, 21, 39
Central Ill. Pub. Serv. Co. v. *United States*, 435 U.S. 21 (1978)	45
Charles C. Steward Mach. Co. v. *Davis*, 301 U.S. 548 (1937)	9, 39, 40
Chevron U.S.A. Inc. v. *Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984)	49
Christensen v. *Harris County*, 120 S. Ct. 1655 (2000)	10, 49
Commissioner v. *Court Holding Co.*, 324 U.S. 331 (1945)	29
Commissioner v. *Wodehouse*, 337 U.S. 369 (1949)	31
Cottage Sav. Ass'n v. *Commissioner*, 499 U.S. 554 (1991)	21, 49
Douglas v. *Willcuts*, 296 U.S. 1 (1935)	29
Flemming v. *Nestor*, 363 U.S. 603 (1960)	14
Green v. *Bock Laundry Mach. Co.*, 490 U.S. 504 (1986)	32
Haggar Co. v. *Helvering*, 308 U.S. 389 (1940)	32
Helvering v. *Davis*, 301 U.S. 619 (1937)	12, 39, 40
Helvering v. *F. & R. Lazarus & Co.*, 308 U.S. 252 (1939)	29
Helvering v. *Stockholms Enskilda Bank*, 293 U.S. 84 (1934)	28, 29
Hillsboro Nat'l Bank v. *Commissioner*, 460 U.S. 370 (1983)	29

TABLE OF AUTHORITIES – continued

	Page
King v. *St. Vincent's Hosp.*, 502 U.S. 215 (1991)	31
Lipke v. *Lederer*, 259 U.S. 557 (1922)	42
Lisbon Shops, Inc. v. *Koehler*, 353 U.S. 382 (1957)	33
Maislin Indus. v. *Primary Steel, Inc.*, 497 U.S. 116 (1990)	49
Massachusetts v. *Morash*, 490 U.S. 107 (1989)	8
Maximov v. *United States*, 373 U.S. 49 (1963)	33
National Muffler Dealers Ass'n v. *United States*, 440 U.S. 472 (1979)	50
National R.R. Passenger Corp. v. *Boston & Maine Corp.*, 503 U.S. 407 (1992)	50
Neal v. *United States*, 516 U.S. 284 (1996)	49
Nierotko v. *Social Sec. Bd.*, 149 F.2d 273 (6th Cir.1945), *aff'd*, 327 U.S. 358 (1946)	16
Norfolk S. Ry. v. *Shanklin*, 120 S. Ct. 1467 (2000)	22
Otte v. *United States*, 419 U.S. 43 (1974)	45
Phelps Dodge Corp. v. *NLRB*, 313 U.S. 177 (1941)	28
Rowan Cos. v. *United States*, 452 U.S. 247 (1981)	45, 50
Social Sec. Bd. v. *Nierotko*, 327 U.S. 358 (1946)	*passim*
Sorenson v. *Secretary of Treasury*, 475 U.S. 851 (1986)	6, 23
United Sav. Ass'n v. *Timbers Of Inwood Forest Assocs., Ltd.*, 484 U.S. 365 (1988)	8, 31, 38
United States v. *Lee*, 455 U.S. 252 (1982)	45
United States v. *Morton*, 467 U.S. 822 (1984)	31
United States v. *Silk*, 331 U.S. 704 (1947)	23, 24, 29, 38, 43
United States v. *Supplee-Biddle Hardware Co.*, 265 U.S. 189 (1924)	41

TABLE OF AUTHORITIES – continued

	Page
United States v. *Swank*, 451 U.S. 571 (1981)	49
United States v. *W. M. Webb, Inc.*, 397 U.S. 179 (1970)	45
United States v. *Williams*, 514 U.S. 527 (1995)	39

STATUTES

Social Security Act of 1935, ch. 531, 49 Stat. 620	11, 13, 17, 46
Revenue Act of 1939, ch. 247, 53 Stat. 862	30
Social Security Act Amendments of 1939, ch. 666, 53 Stat. 1360	*passim*
Revenue Act of 1943, ch. 63, 58 Stat. 21	30
Social Security Act Amendments of 1946, ch. 951, 60 Stat. 978	11, 20, 21
Social Security Act Amendments of 1950, ch. 809, 64 Stat. 477	35, 36
26 U.S.C. § 3101	*passim*
§ 3101 (1982 & Supp. III 1985)	3
§ 3102(a)	46
§ 3111	*passim*
§ 3111 (1982 & Supp. III 1985)	3
§ 3121	*passim*
§ 3301 (1982 & Supp. III 1985)	3
§ 3301	*passim*
§ 3306(b)(1) (1982 & Supp. III 1985)	3
§ 3306	4, 30, 36, 37
§ 6413(a)	5
§ 6532	5
§ 7422	5
28 U.S.C. § 294	33
§ 371	33
§ 409	23
§ 410	23
§ 413(a)(2)	15, 34

TABLE OF AUTHORITIES – continued

	Page
42 U.S.C. § 414	15
§ 415	15, 34
§ 430	23
26 C.F.R. § 31.3101-2	27
§ 31.3102-1	46
§ 31.3111-1	39
§ 31.3121(a)-2	10, 22, 28
§ 31.3121(v)(2)-1	48
§ 31.3301-2	39
§ 31.6001-2	47
§ 31.6001-4	47
§ 31.6402(a)-2(a)(2)	5
§ 31.6413(b)-1	5
50 Fed. Reg. 45,558 (1985)	3
51 Fed. Reg. 40,256 (1986)	3
58 Fed. Reg. 58,004 (1993)	4
65 Fed. Reg. 63,663 (2000)	43
Treas. Reg. § 91 (1936)	13
Rev. Rul. 89-35, 1989-1 C.B. 280	4, 50
Mim. 6040, 1946-2 C.B. 155	26
Gen. Couns. Mem. 36,732 (May 19, 1976)	45

LEGISLATIVE HISTORY

S. Rep. No. 74-628 (1935)	12, 13
S. Rep. No. 76-734 (1939)	*passim*
S. Rep. No. 81-1669 (1950), *reprinted in* 1950 U.S.C.C.A.N. 3287	33
S. Rep. No. 92-1230 (1972)	34
H.R. Rep. No. 76-728 (1939)	24, 25, 26, 27, 28
H.R. Rep. 79-2447 (1946)	21
H.R. Rep. 98-25 (1983), *reprinted in* 1983 U.S.C.C.A.N. 219	23
H.R. Conf. Rep. No. 91-1037 (1970), *reprinted in* 1970 U.S.C.C.A.N. 3646	37

TABLE OF AUTHORITIES – continued

	Page
Statement of President Roosevelt Upon Signing the Social Security Act, Aug. 14, 1935, *in* 4 *The Public Papers And Addresses Of Franklin D. Roosevelt* (1938)	13

OTHER AUTHORITIES

The 2000 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds (2000)	40, 45
The Value Of A Dollar, 1860-1999 (Scott Derks ed., 1999)	35, 36
Robert M Ball et al., 1994-96 Advisory Council on Soc. Sec., *Social Security for the 21st Century* (1997), *available at* http://www.ssa.gov/history/reports/adcouncil/report/ball1.htm...	14
Martha A. McSteen, *Fifty Years of Social Security* (1985), *available at* http://www.ssa.gov/history/50mmw.html	12, 13, 15
Social Sec. Admin., SSA Pub. No. 05-10095, *How It's Financed* (Aug. 1999)	14
Social Sec. Admin., SSA Pub. No. 957, *Reporting Back Pay and Special Wage Payments to the Social Security Administration* (1997)	47

BRIEF FOR RESPONDENT

STATEMENT OF THE CASE[1]

Respondent the Cleveland Indians Baseball Company ("Cleveland Indians") is one of 26 Major League Baseball clubs that operated in the years 1985 to 1990. In that period, the relationship between the clubs and the Major League Baseball Players Association ("MLBPA") was governed by a Collective Bargaining Agreement ("CBA"). Beginning in 1986, the MLBPA filed three separate grievances claiming that the clubs violated Article XVIII(H) of the CBA by acting in concert before the 1986, 1987 and 1988 seasons to hinder the movement and depress the salaries of players who, because of their years of service in baseball, were "free agents" (*i.e.*, free to sign a contract to play with any club). The MLBPA further alleged that the concerted action injured players of all seniority levels by depriving them of salary and nonsalary benefits in the period from 1986 to 1990. J.A. 21-22.

Under the CBA, grievances are submitted to an arbitration panel. In 1989 and 1990, an arbitration panel ruled that the clubs had interfered with the contractual rights of the players before the 1986, 1987 and 1988 seasons and that collectively the players suffered damages measured by salary. That ruling did not determine what any individual player's salary would have been absent the injury. Before the panel rendered any decision as to claims of salary damages for years other than 1986, 1987 and 1988, or claims of nonsalary damages in any year, the clubs and the MLBPA settled the three grievances on December 21, 1990. The settlement agreement required the clubs to pay $280 million into two custodial accounts to be administered by a custodian pursuant to a framework for

---

[1] This case was decided on stipulated facts. *See* J.A. 21-29.

distributions that would be proposed by the MLBPA and approved by an arbitrator. In 1992, the MLBPA proposed to the arbitrator a partial distribution plan that called for payments to individual players whose claims for salary damages related to the 1986 and 1987 seasons. In February 1994, the arbitrator issued the award for 1986 and 1987 salary damages (plus interest) that is at issue in this case, allocating sums to individual players.[2] J.A. 22-25.

Under the settlement agreement, the Cleveland Indians were considered to be the employer of eight former Indians players who received distributions in 1994 for 1986 salary damages, and 15 former Indians players who received distributions in 1994 for 1987 salary damages. In all, there were 18 different players who received awards, with five players receiving distributions for both 1986 and 1987. With one exception,[3] each of the players had played for (and received wages from) the Cleveland Indians in the year for which he received an award. None of those players played for, or was employed by, the Cleveland Indians in 1994. The 1986 salary damages awarded to former Indians players totaled $610,000 plus $219,638 in interest. The 1987 salary damages totaled $1,457,848 plus $409,119 in interest. J.A. 25-26.

This case concerns the federal employment taxes owed on the awards. The Federal Insurance Contributions Act ("FICA") and the Federal Unemployment Tax Act ("FUTA")

---

[2] Subsequently, the arbitrator issued an award in 1995 for 1986 and 1987 nonsalary damages; an award in 1997 for 1988 salary damages; an award in 1999 for 1989 salary damages; and another award in 1999 for 1988 and 1989 nonsalary damages. Awards for later years are still to come.

[3] One player who received a 1987 damages award did not play for respondent in that year, but was deemed to be an employee under the settlement agreement because respondent was the last club that employed him prior to the 1987 season. J.A. 25.

are the names of the two tax titles of the Social Security Act. See Social Security Act Amendments of 1939, ch. 666, sec. 607, § 1432, sec. 615, § 1611, 53 Stat. 1360, 1387, 1396. FICA imposes a tax upon both the employer and the employee based on wages paid or received during a calendar year, for the purpose of funding Social Security and Medicare hospitalization benefits. 26 U.S.C. §§ 3101, 3111. FUTA imposes a tax on qualifying employers based on wages paid during a calendar year to fund unemployment benefits. 26 U.S.C. § 3301.

In 1986 and 1987, for both employees and employers, the FICA Social Security and Medicare tax rates were 5.7 % and 1.45% respectively. See 26 U.S.C. §§ 3101(a), (b); 3111(a), (b) (1982 & Supp. III 1985). Those rates applied only to wages that were within the "contribution and benefit base" established by the Social Security Administration ("SSA") for that year. See *id.* § 3121(a)(1). The base was $42,000 in 1986 and $43,800 in 1987. 50 Fed. Reg. 45,558, 45,559 (1985); 51 Fed. Reg. 40,256, 40,257 (1986). In both 1986 and 1987, the FUTA tax was 6.0% on wages up to $7,000. 26 U.S.C. §§ 3301, 3306(b)(1) (1982 & Supp. III 1985). In 1986 and 1987, all of the players (except one) who later received a back pay award for those years were paid actual wages by respondent in excess of both the FICA and FUTA wage ceilings. Those players thus paid the maximum FICA tax in 1986 and 1987. Respondent also paid the maximum employer FICA and FUTA taxes in 1986 and 1987 on the wages to those players. See App. to Pls.' Mot. Summ. J., Ex. 10, Docket No. 27, No. 96-CV-2240 (N.D. Ohio Jan. 30, 1998) ("Pls. App.") (1986 and 1987 W-2 information).

One of the critical employment tax issues was whether the 1986 and 1987 tax rates and wage ceilings, or their 1994 counterparts, applied to the award for 1986 and 1987 lost salary. In *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), this Court, construing a provision of the Social Security Act that awarded benefit credits based on "wages"

"paid" in a calendar period, held that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual." *Id.* at 370. In *Bowman* v. *United States*, the United States Court of Appeals for the Sixth Circuit – in which circuit respondent resides – held that the *Nierotko* relation-back rule governs the taxation of back pay. 824 F.2d 528, 530 (6th Cir. 1987). The Internal Revenue Service ("IRS"), however, has rejected *Bowman* and refused to apply *Nierotko* in assessing taxes, ruling that back pay should be taxed at the rates in effect in the year of the award. Rev. Rul. 89-35, 1989-1 C.B. 280.

The tax consequences of the IRS ruling are considerable. Because the players and respondent had paid the maximum FICA and FUTA taxes in 1986 and 1987, under *Nierotko* and *Bowman* no tax would be owed on the distributions compensating the players for the loss of additional salary in those years.[4] But if the 1994 rates and ceilings applied, both the players and respondent would face significant tax liability, because respondent had paid none of the players any wages in 1994. Such taxes would also be assessed at higher rates and on a much larger wage base.[5]

Because of these and other tax issues, the clubs asked the IRS for a private-letter ruling in 1993. The arbitrator issued the 1994 award, however, before the IRS responded. Given the uncertain tax situation, respondent and the other clubs paid the employer's share of FICA and FUTA taxes on the

[4] The exception would be the one player who was deemed an employee of respondent for the purposes of the 1987 award. Respondent paid him no wages in 1987, so it would owe tax on his distribution.

[5] The employee and employer FICA tax rate had risen in 1994 to 6.2% and the wage base had risen to $60,600. 26 U.S.C. §§ 3101, 3111; 58 Fed. Reg. 58,004, 58,005. The Medicare tax rate had stayed at 1.45%, but the wage ceiling no longer applied to this tax. 26 U.S.C. § 3121(a). The FUTA tax rate had risen to 6.2% on the same wage base of $7,000. 26 U.S.C. §§ 3301, 3306(b).

entire awards as if they were wages paid in 1994. Respondent's FICA tax payment was $99,381.90, and the FUTA payment was $1,008. Respondent also withheld $99,381.90 on behalf of the Cleveland Indians players to pay the employee FICA tax at 1994 rates. J.A. 26.

The IRS issued its private letter ruling on October 18, 1995. It ruled that (1) the individual clubs were properly identified as employers; (2) the interest component of the award was not wages; (3) the damages component was wages; and (4) such wages were to be attributed to 1994. On February 21, 1996, the respondent filed claims with the IRS for refunds of the FICA and FUTA taxes, arguing that neither the interest nor the damages were wages, and, in the alternative, that the back pay should be attributed to the calendar years 1986 and 1987 for tax purposes. Sixteen of the 18 players joined the refund claims, pursuant to 26 U.S.C. § 6413(a). J.A. 26.

Because the IRS had not acted on the refund claim within six months of filing, respondent commenced this action, asserting the same legal arguments set forth in its refund claim. Cf. 26 U.S.C. §§ 6532, 7422.[6] Certain issues were resolved by stipulation. The Government stipulated that the interest was not taxable, and respondent stipulated for purposes of this case that the damages component was taxable "wages."[7] After the stipulation the only remaining issue for summary judgment was whether the *Nierotko* rule applied, such that the back pay wages would be deemed "paid" in

[6] Respondent brought suit to recover only the taxes it had paid, not those of the players who had joined respondent's refund claim pursuant to 26 U.S.C. § 6413(a) and 26 C.F.R. §§ 31.6402(a)-2(a)(2), 31.6413(b)-1.

[7] The difference in tax liability for respondent between a ruling that the damages were not wages and a ruling that the wages related back to 1986 to 1987 was minor (approximately $3,000). *Cf.* J.A. 26 (¶ 14), 27 (¶ 18). Other clubs continue to litigate whether the damages awards are "wages" within the meaning of FICA and FUTA, and this case should not prejudice that litigation.

1986 and 1987. J.A. 26-27. The district court awarded judgment to respondent on the authority of *Bowman*, and the court of appeals affirmed on the same basis. Pet. App. 5a, 10a.

SUMMARY OF ARGUMENT

In its brief, the Government presents this case as a simple one in which its position is assertedly compelled by the plain language of the statute, the legislative history, and Treasury regulations. The simplicity of its argument masks a fundamental error, for it is the Government's position that is contrary to this Court's precedent and the plain meaning of the statute as a whole.

First, the Government's position is irreconcilable with *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946). The Government's argument is that, ever since the Social Security Act Amendments of 1939 ("1939 Act"), federal employment taxes have been assessed based on "wages paid" during a calendar year. According to the Government, the statutory "wages paid" rule necessarily means that a back pay award for lost wages in prior years is taxed in the year of the award. But in *Nierotko*, this Court interpreted parallel "wages paid" language from another part of the 1939 Act that governed eligibility for Social Security benefits. The *Nierotko* Court held that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual." *Id.* at 370. *Nierotko* thus directly refutes the Government's claim that its position is compelled by the plain text of a "wages paid" statute. Moreover, it is a fundamental principle of statutory construction that the same language in different parts of the same legislation should be interpreted the same way unless there are compelling reasons to do otherwise. *Sorenson* v. *Secretary of Treasury*, 475 U.S. 851, 860 (1986). No such reasons exist, and indeed in *Nierotko* the Government specifically argued to this Court that the tax and benefit titles of the 1939 Act were to be construed *in pari materia*. The

Government does not ask this Court to overrule *Nierotko*, which is still followed by the Social Security Administration. *Nierotko* controls this case.

The Government falls into error because it misapprehends the statutory basis of this Court's relation-back holding in *Nierotko*. It is under the misimpression that the relation-back holding was based on the definition of "wages" in section 210 of the Social Security Act of 1935. Section 210 of the 1935 Act was the basis only for the first question decided in *Nierotko*: namely, whether the back pay award at issue in that case qualified as "wages" within the meaning of the Social Security Act. 327 U.S. at 360, 362-63. But this Court was explicit that the second question decided in *Nierotko* – whether back pay "wages" would be deemed "paid" in the year of the award or the year in which they should have been paid – was based on section 209(g) of the 1939 Act, which made benefits eligibility depend on the "calendar quarters" or "calendar year" in which "wages" had been "paid." *Id.* at 362 n.7, 370 & n.25.

This basic error infects the Government's argument at every turn. It vitiates the Government's principal argument for distinguishing *Nierotko*: namely, that Congress amended the definition of "wages" in section 210(a) of the 1935 Act in the Social Security Act Amendments of 1946 ("1946 Act"). The 1946 Act did not alter section 209(g) of the 1939 Act, the statute on which *Nierotko*'s relation back holding was based. Indeed, far from supporting the Government's position, the 1946 Act refutes it. The 1946 Act adopted a "wages paid" rule for calculating the wage base for purposes of both Social Security benefits and federal employment taxes. It did so only a few months after *Nierotko* had interpreted the meaning of a "wages paid" rule as applied to back pay. The 1946 Act thus must be deemed to have incorporated *Nierotko*'s construction of that statutory language for both the benefits and tax titles of the Social Security Act. *Cannon* v.

University of Chicago, 441 U.S. 677, 696-99 (1979). The 1946 Act further confirms that *Nierotko* controls this case.

The Government's failure to realize that *Nierotko* is a construction of a statutory "wages paid" rule leads it into another critical error. The Government repeatedly argues that adherence to *Nierotko* would resurrect the "wages payable" taxation rules that Congress abandoned in the 1939 and 1946 Acts in order to simplify employer accounting of year-end pay. According to the Government, like the former "wages payable" rule, *Nierotko* would require taxes to be assessed based on the year in which services were performed. The *Nierotko* rule does nothing of the kind. As a construction of "wages paid" language that is necessary for the effective operation of the statute as applied to back pay, *Nierotko* requires taxes to be assessed based on the rates in effect in "the periods when the regular wages were not *paid* as usual," 327 U.S. at 370 (emphasis added), regardless of the year in which services were performed. The Government's entire argument that the *Nierotko* rule conflicts with the statutory text, legislative history, and implementing regulations is built on the misconception that *Nierotko* would restore the "wages payable" rule. Once that error is exposed, the Government's argument topples like a house of cards.

Second, the Government's proposed interpretation of the "wages paid" language in the tax statutes is at odds not only with *Nierotko*, but also with the plain meaning of the statute as a whole. This Court has instructed that "[t]he plain meaning that we seek to discern is the plain meaning of the whole statute, not of isolated sentences." *Beecham* v. *United States*, 511 U.S. 368, 372 (1994); see also *Massachusetts* v. *Morash*, 490 U.S. 107, 115 (1989) ("'in expounding a statute, we [are] not . . . guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy'") (alteration and omission in original) (quoting *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 51 (1987)); *United Sav. Ass'n* v. *Timbers Of Inwood Forest*

Assocs., Ltd., 484 U.S. 365, 371 (1988). Both at present and historically the definitions of taxable "wages" and "employment," and of "employers" liable for tax, have depended on some event or status at the time of payment (*e.g.*, some payments are not taxable if paid a certain number of months after employment has ceased). If back pay wages are not deemed "paid" at the time they should have been paid, those definitions are rendered nonsensical. In a number of circumstances, wages that would not have been taxed when they should have been paid become taxable under the Government's rule, penalizing the *employee* for the employer's wrongdoing. In other circumstances, wages that would have been taxed are not taxed, rewarding the employer for its wrongdoing with a windfall and depriving the Social Security trust funds of revenue. The Social Security Act is predicated on wages paid for employment in the ordinary course, and the *Nierotko* rule is necessary for its rational operation in the unusual circumstance of a back pay award.

Finally, as the plain language of the statute and this Court's precedents make clear, the FICA and FUTA taxes on employers are excise taxes on the act of employment. *Charles C. Steward Mach. Co.* v. *Davis*, 301 U.S. 548, 578 (1937). Wages paid in a calendar year are the measure of the tax, but the payment of wages is *not* the act on which the tax is imposed. The Government's rule generates perverse results where identical employment relations are taxed at wildly disparate rates based on arbitrary factors; where, because the SSA continues to apply *Nierotko*, the employee may receive multiple years of benefits credit for a back pay award when only one year of tax is paid, or none at all; and where employers have incentives to create or prolong wage disputes because the Government's rule promises potential reduction or even elimination of taxation. The Government's rule is antithetical to the text, structure, history and policy of the Act, and is inconsistent with this Court's precedents.

No deference is owed to the Government on the question presented. The Treasury Regulations do not even address back pay, and are substantively unchanged from a period in which the IRS held a position on back pay that was rejected as "unsound" by this Court in *Nierotko*. 327 U.S. at 367. Moreover, the Government's argument that application of *Nierotko* would conflict with the regulations again depends on the false presupposition that *Nierotko* requires taxation based on the year in which services were performed. *Nierotko* is a construction of the "wages paid" rule as applied to *back pay* that is fully compatible with the regulation. *Id.* at 370. The IRS has issued revenue rulings that reject *Nierotko*, but those rulings are not entitled to *Chevron* deference, which is reserved to notice-and-comment regulations and adjudications that have the force and effect of law. *Christensen* v. *Harris County*, 120 S. Ct. 1655, 1662 (2000). Regardless, deference is never owed to administrative rulings that are inconsistent with the precedents of this Court and are irreconcilable with the statute, and do not even address (much less justify) the anomalies they create. There is no reasoned basis for the IRS's failure to follow *Nierotko*, and this Court should affirm the judgment below.

ARGUMENT

Ever since the Social Security Act Amendments of 1939, ch. 666, 53 Stat. 1360 ("1939 Act"), federal employment taxes have been assessed based on "wages . . . paid" during a calendar year. 26 U.S.C. §§ 3111 (FICA), 3301 (FUTA).[8] In

[8] The FICA tax on an employee's income is "equal to" specified percentages for a given calendar year "of the wages (as defined in section 3121(a)) *received* by him with respect to employment (as defined in section 3121(b))." 26 U.S.C. § 3101 (emphasis added). "In general, wages are received by an employee at the time that they are paid by the employer to the employee," either actually or constructively. 26 C.F.R. § 31.3121(a)-2(a). Because wages are received when paid, this brief will, for simplicity's sake, refer to all federal employment taxes (including those on the employee) as assessed on a "wages paid" basis.

Social Security Board v. *Nierotko*, 327 U.S. 358 (1946), this Court, construing parallel language from the benefits title of the 1939 Act, held that back pay "wages" are deemed "paid" in "the periods when the regular wages were not paid as usual." *Id.* at 370 & n.25. In the decision below, and in *Bowman* v. *United States*, 824 F.2d 528, 530 (6th Cir. 1987), the court of appeals held that the *Nierotko* rule governs the taxation of back pay. The Government challenges the applicability of *Nierotko* to the tax provisions of the 1939 Act, but its arguments are built on misconceptions. The Government misconceives the statutory basis of *Nierotko*'s relation-back holding, the interrelationship of the tax and benefits titles, and the meaning of the statute as a whole.

The argument of this brief proceeds as follows. Part I.A describes the original Social Security Act of 1935, ch. 531, 49 Stat. 620 ("1935 Act"), and the changes made in the 1939 Act. Understanding the fundamental structure of the Social Security Act is critical to understanding why *Nierotko* is correct that back pay "wages" are deemed "paid" when they should have been paid. Part I.B demonstrates that *Nierotko*'s relation-back holding is based on a "wages" "paid" provision of the 1939 Act, which provision has not been amended in any material respect. That holding was not based on any part of the 1935 Act, as the Government mistakenly contends. Part I.C demonstrates that the Government's argument that *Nierotko* was undermined by the Social Security Act Amendments of 1946, ch. 951, sec. 412, §§ 1426, 1607, sec. 414, § 209, 60 Stat. 978, 989, 990-91 ("1946 Act"), is simply a product of its misconception of the statutory basis of this Court's decision. Indeed, the 1946 Act is fatal to the Government's argument because its adoption of a "wages paid" rule for both the benefits and tax titles in the wake of *Nierotko* must be deemed to have confirmed the *Nierotko* relation-back principle as a generally applicable rule for back

pay. Part I.D shows that the benefits and tax titles of the 1939 Act (as amended) must be construed *in pari materia* as a matter of statutory structure and legislative history. Indeed, the Government specifically argued in *Nierotko* that those titles must be so construed. Part I.E demonstrates that the Government's entire argument – that applying *Nierotko* to the tax titles is in conflict with the statutory text, the legislative history, and Treasury regulations – is based on the false premise that *Nierotko* resurrects the "wages payable" rule abandoned in the 1939 Act. Part II demonstrates the inconsistency of the Government's rule with the plain meaning of other provisions of the statute, and thus with the statute as a whole, and with its object and policy. Finally, Part III explains why the Government's position is not entitled to deference.

I. THE GOVERNMENT'S LEGAL ARGUMENT CONFLICTS WITH THE PLAIN MEANING AND PURPOSES OF THE STATUTES.

A. The Social Security Acts Of 1935 And 1939.

The reliance of Americans on cash wages increased dramatically during the rapid change from a farm-based to an urban industrial economy in this country in the late nineteenth and early twentieth centuries. Martha A. McSteen, *Fifty Years of Social Security* 2 (1985), *available at* http:www.ssa.gov/history/50mm2.html; *Helvering* v. *Davis*, 301 U.S. 619, 642 (1937). With that shift came vulnerability to changing economic conditions. The Great Depression visited destitution upon wage earners, especially the growing number of elderly, who commonly were laid off in favor of stronger younger workers and had no adequate means to support themselves in a wage-based economy. *Helvering* v. *Davis*, 301 U.S. at 642-43; S. Rep. No. 74-628, at 4 (1935).

1. Social Security Act of 1935

Given the insufficient financing of state and local programs to provide income security for the aged, *Helvering* v. *Davis*,

301 U.S. at 644; S. Rep. No. 74-628, at 6, Congress responded by passing the Social Security Act of 1935 to establish old-age benefits funded by employment taxes on wages. 1935 Act, 49 Stat. 620; *Nierotko*, 327 U.S. at 362 ("The benefits are financed by payments from employees and employers which are calculated on wages."). Title II of the 1935 Act established an Old-Age Reserve Account in the Treasury of the United States from which benefits would be paid to "'qualified individual[s],'" defined as those over 65 who had earned at least $2,000 in wages in five years in which they worked after December 31, 1936. 1935 Act, §§ 201(a), 210(c), 49 Stat. at 622, 625. Those benefits were based on a specified percentage of total wages paid to such qualified individuals after that date. *Id.* § 202, 210(c), 49 Stat. at 623, 625. To fund those benefits, Title VIII of the 1935 Act imposed employment taxes on both employees and employers (with certain exemptions) as a percentage of wages "paid" or "received" "with respect to employment during the calendar year[]." *Id.* §§ 801, 804, 49 Stat. at 636, 637. Title IX also imposed an unemployment tax on employers of eight or more employees on the same basis. *Id.* § 901, 49 Stat. at 639. The Bureau of Internal Revenue interpreted those provisions to require that taxes be assessed on wages payable for services performed during a given year, even if not actually paid during that year. Treas. Reg. § 91, arts. 202, 302 (1936).

2. Social Security Act Amendments of 1939

The 1935 Act was recognized even at its passage as "a cornerstone in a structure which is being built but is by no means complete." Statement Of President Roosevelt Upon Signing the Social Security Act, Aug. 14, 1935, *in* 4 *The Public Papers And Addresses Of Franklin D. Roosevelt* 324 (1938). Accordingly, Congress in the 1939 Act substantially revised both the benefits and tax provisions, and thus defined the basic program structure existing today. McSteen, *supra*, at 5 ("Following implementation of the 1939 amendments, the basic Social Security program was in place.").

First, the 1939 Act created the Social Security Trust Fund to pay out benefits. 1939 Act, § 201, 53 Stat. at 1362. Maintaining the link between Social Security taxes and benefits, Congress in the 1939 Act directed that "[t]here is hereby appropriated to the Trust Fund for the fiscal year ending June 30, 1941, and for each fiscal year . . . amounts equivalent to 100 per centum of the taxes . . . received under the Federal Insurance Contributions Act and covered into the Treasury." *Id.* Thus, while Social Security tax "contributions," unlike private pension contributions, do not create in the contributor a property right to benefits against the government, and wages rather than contributions are the statutory basis for calculating an individual's benefits, *Flemming* v. *Nestor*, 363 U.S. 603, 609 (1960), it has always been true that "Social Security taxes are used to pay for Social Security benefits." Social Sec. Admin., SSA Pub. No. 05-10095, *How It's Financed* (Aug. 1999); Robert M. Ball et al., 1994-96 Advisory Council on Soc. Sec., *Social Security for the 21st Century* 35 (1997) ("Social Security is an earned right growing out of past work and contributions, self-financed entirely by dedicated deductions from workers' earnings matched by the employer, by taxes on Social Security benefits, and by earnings on the trust funds."), *available at* http://www.ssa.gov/history/reports/adcouncil/report/ball1.htm.[9]

Second, Congress in 1939 established a common basis for determining both eligibility for Social Security benefits and liability for Social Security taxes: the "wages" that are "paid" during a particular period of the calendar year. On the benefits side, Title II of the 1939 Act created a new section 209 to make eligibility for benefits depend on "wages" that are "paid" during calendar quarters. The Act established two

[9] Social security taxes are used to purchase special Treasury securities that are held by the trusts and redeemed when necessary to secure funds to pay benefits. Social Sec. Admin., SSA Pub. No. 05-10095, *How It's Financed* (Aug. 1999).

categories of beneficiaries: "'fully insured'" and "'currently insured'" individuals, defined in terms of the number of calendar-year quarters of coverage that an individual had accumulated. 1939 Act, § 209(g), (h), 53 Stat. at 1376-77; McSteen, *supra*, at 5 (quarters-of-coverage rule is "[a] method of measuring whether an individual had worked long enough in covered employment to get a benefit"). A "'fully insured' individual" was someone eligible for both old-age and survivorship benefits, whereas a "'currently insured' individual" was eligible only for survivorship benefits. More quarters of coverage were required to reach "fully insured" status. S. Rep. No. 76-734, at 13, 60-61 (1939). The 1939 Act defined a quarter of coverage as (i) "a calendar quarter in which the individual has been *paid* not less than $50 in *wages*" or (ii) any quarter (except the first) "[i]n any case where an individual has been *paid in a calendar year* $3,000 or more in *wages*." 1939 Act, § 209(g), 53 Stat. at 1377 (emphasis added).[10] This is the same benefits scheme that, with minor changes not relevant here, is still in place in the current Social Security Act. 42 U.S.C. § 413(a)(2) (defining quarters of coverage in terms of wages "paid"); *id.* § 414 (defining "'fully'" and "'currently insured'" individuals in terms of quarters of coverage); McSteen, *supra*, at 5 (quarters of coverage is "the measure on which today's methods are based"). The amount of benefits a Social Security beneficiary will receive has also since 1939 related to wages "paid" through the calculation of an average monthly wage. See 1939 Act, §§ 202, 209(e), (f), 53 Stat. at 1363-66, 1376; 42 U.S.C. § 415.

In a parallel change to the tax title of the Act, Title VI of the 1939 Act amended the Internal Revenue Code to calculate Social Security taxes on the basis of "wages" that were "paid"

[10] Although it is technically accurate, given the ordering of the words in the text, to speak of section 209(g) as placing benefits eligibility on a "wages" "paid" basis, for simplicity this brief will use the convention "wages paid" in referring to the section 209(g) rule henceforth.

or "received" during a calendar year. See 1939 Act, sec. 601, § 1400, sec. 604, § 1410, sec. 608, § 1600, 53 Stat. at 1381-82, 1387. As before, the wages subject to tax were limited by a statutory ceiling (in 1939, $3,000). See *id.* sec. 606, § 1426, sec. 614, § 1607, sec. 608, § 1600, 53 Stat. at 1383, 1387, 1392-93. This same structure persists to the present day, and these are the provisions at issue in this case. See 26 U.S.C. §§ 3101, 3111, 3301; *id.* § 3121. The critical point is that the 1939 Act established a "wages paid" rule for both benefits eligibility and taxation.

B. Applying The "Wages Paid" Language Of The 1939 Act, *Nierotko* Held That Back Pay "Wages" Are Deemed "Paid" In The Year In Which They Would Have Been Paid But For The Wrongful Conduct.

In *Nierotko*, this Court decided the proper treatment of back pay under the Social Security Act. Back pay was not expressly addressed in either the statutory text or the legislative history. 327 U.S. at 364. In *Nierotko*, the Ford Motor Company had wrongfully discharged an employee, Nierotko, for union activity. The National Labor Relations Board reinstated Nierotko and ordered back pay for the period of February 2, 1937 to September 25, 1939. Ford paid the back pay award on July 18, 1941. The Social Security Board, however, refused to give Nierotko credit for the back pay in determining his eligibility for benefits and the amount of those benefits. Nierotko filed suit, but the district court affirmed the Board. *Id.* at 359-60. On appeal, the United States Court of Appeals for the Sixth Circuit reversed, holding that back pay was "wages" within the meaning of the Act and had to be apportioned back to the period in which wages would have been paid but for the employer's wrongful conduct. 149 F.2d 273, 274 (6th Cir. 1945). This Court granted certiorari to determine whether the back pay award was "wages" within the meaning of the Act, and, if so, "the proper allocation of such sums to the quarters of coverage for which the 'back pay' was allowed." 327 U.S. at 359.

In tackling the issue of whether the back pay award constituted Social Security "wages," this Court held that the definition of "wages" in the 1935 Act governed that question because it was in effect "[d]uring the period for which 'back pay' was awarded" (*i.e.*, 1937-1939). *Id.* at 360.[11] Section 210(a) of the 1935 Act defined "wages" as "all remuneration for employment," and section 210(b) in turn defined "employment" as "any service, of whatever nature, performed within the United States by an employee for his employer." § 210(a), (b), 49 Stat. at 625.

The Court first held that Nierotko's back pay was "remuneration" within the meaning of section 210(a) of the 1935 Act because it was a reparation for lost wages. *Nierotko*, 327 U.S. at 364-65. The Court next held that back pay was remuneration for "employment" under section 210(b) because it was for an employee's "service," even though the employee did not do any work for the employer between 1937 and 1939. This Court construed the term "service" to encompass the entire employer-employee relationship. *Id.* at 365-66. In reaching this conclusion, the Court rejected the Solicitor General's argument that it should defer to the Bureau of Internal Revenue's contrary administrative interpretation of the term "wages," which had been adopted by the Social Security Board, see *id.* at 367. Cf. Brief for the Social Security Board at 15-18, *Social Sec. Bd.* v. *Nierotko*, 327 U.S. 358 (1945) (No. 318) ("U.S. *Nierotko* Br."). The Court acknowledged that "[the benefits and] tax titles of the Social Security Act have identical definitions of wages and employment," 327 U.S. at 363, but declared the Bureau of Internal Revenue's position "unsound" and "beyond the permissible limits of administrative interpretation." *Id.* at 367, 370.

---

[11] The amendments of the 1939 Act did not become effective until January 1, 1940. *Nierotko*, 327 U.S. at 360.

Having established that the back pay awarded to Nierotko met the textual definition of "wages" under section 210 of the 1935 Act, this Court next addressed the Government's argument that back pay could not be apportioned to prior periods for benefits purposes because the "Amendments of 1939 use 'quarters' as the basis for eligibility as well as the measure of benefits and require 'wages' to be 'paid' in certain 'quarters.'" *Id.* at 370 & n.25. Even though the 1935 Act governed the first question of whether the back pay for the period of 1937 to 1939 was "wages," section 209 of *the 1939 Act* was applicable to this second question because it concerned Nierotko's current and prospective eligibility for benefits as a "fully insured" or "currently insured" individual.

Employing the same arguments it renews today, the Government contended that the "wages paid" language of section 209(g) and (h) of the 1939 Act was dispositive. It invoked the provision of section 209(g) that an individual is fully insured only if he has accumulated enough "quarters of coverage" "'in which the individual has been paid not less than $50 in wages.'" U.S. *Nierotko* Br. 10 (emphasis omitted) (quoting § 209(g)(2)). The Government argued that the relation-back holding of the court of appeals was in "conflict[] with the language of the Act," *id.* at 11, because (with the exception of the rule for an individual with $3,000 in annual wages) "quarters of coverage clearly were understood to arise only from those quarters in which 'wage' payments of $50 or more *actually occurred*." *Id.* at 13 (emphasis added).

Significantly, the Government supported this argument by contending that the benefits-eligibility amendment in Title II of the 1939 Act had to be interpreted *in pari materia* with the tax amendments of Title VI of the same Act that assessed taxes based on "wages paid" in the calendar period (*i.e.*, the tax provisions at issue in this case). The Solicitor General pointed out that the new section 209 and the new tax provisions were part of the "same amendatory Act," and that

references to a period "'in which'" "'wages'" were "'paid'" "were used advisedly." *Id.* He argued that "[w]here Congress wished wage payments to be allocated to periods other than the period in which they were actually paid, it knew how to use appropriate language." *Id.* at 13-14. The Solicitor General acknowledged that allocation of the back pay over the period for which it was awarded was necessary to put the employee "in exactly the same position as if he had never been wrongfully discharged," *id.* at 5, but contended that "apportionment of 'back pay' over the entire 'back pay' period would conflict with the express terms of the Act." *Id.* at 14.

This Court unanimously rejected the Government's putative plain-language argument. The requirement of the 1939 Amendments that "'wages' . . . be 'paid' in certain 'quarters'" did not dictate such a perverse result, 327 U.S. at 370. In interpreting the statutory text as applied to back pay, which by its nature is a reparation to make the wronged employee whole, *id.* at 364, this Court adopted a relation-back principle that deems wages to be "paid" in the year the wages should have been paid: "If, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods when the regular wages were not paid as usual." *Id.* at 370. Indeed, this Court could not logically have reached any other result. If the characterization of the back pay as statutory "wages" is resolved by reference to "the period for which 'back pay' was awarded" (*i.e.*, 1937-1939), *id.* at 360, then necessarily the question of when such "wages" are deemed "paid" likewise must relate back to that period. Moreover, it would be contrary to the very purposes of the Act if an employee would fail to qualify for *any* benefits under the Act – by having too few quarters of coverage to qualify as a "fully insured" or "currently insured" individual – because of an employer's wrongdoing.

C. The Government's Argument That *Nierotko* Was Undermined By The 1946 Act Is Based On Its Misunderstanding Of This Court's Decision.

The Government's efforts to distinguish *Nierotko* are not only unpersuasive but ultimately puzzling. Its principal argument is that *Nierotko* was based on the definition of "wages" in section 210(a) of the 1935 Act, and that one part of that definition – the $3,000 ceiling on remuneration in a calendar year that counts as "wages" for Social Security purposes – was amended in 1946 along with the corresponding provisions of FICA and FUTA. U.S. Br. 26-27; see 1946 Act, sec. 412, §§ 1426, 1607, sec. 414, § 209, 60 Stat. at 989, 990-91.

This argument is utterly irrelevant and wrong, and based on a flat misreading of *Nierotko*. First, the wage ceiling was not at issue in *Nierotko*. Second, and more critically, as noted above, *Nierotko* relied on section 210(a) of the 1935 Act only to determine whether "back pay" fit the statutory definition of "wages." 327 U.S. at 360, 362-63. That issue is not contested here, and indeed the parties have stipulated in this case that the particular award here qualifies as "wages" within the meaning of the Act (although other Major League Baseball clubs are litigating that question in other cases). Solely at issue here is *Nierotko*'s relation-back holding. *That* holding was based on section 209(g) of the *1939 Act* (the "wages paid" rule for determining benefits eligibility) and not on any provision of the 1935 Act. 327 U.S. at 370. Thus, the Government does not even acknowledge the statutory "wages paid" basis of *Nierotko*'s relation-back holding, even though it was the Government that relied upon section 209(g) of the 1939 Act in its argument to the Court in *Nierotko*. Cf. U.S. *Nierotko* Br. 4 (raising the proper interpretation of section 209(g) in its specification of errors).

Indeed, far from supporting the Government's position, the 1946 Act is fatal to it. The critical point is that the 1946 Act adopted a "wages paid" rule for the calculation of the Social

Security wage base for both benefits *and* taxes. 1946 Act, sec. 412, §§ 1426, 1607 (amending the definition of wages in FICA and FUTA), sec. 414, § 209(a) (amending the definition of wages in the benefits title), 60 Stat. at 989-91. On the benefits side, Congress amended section 209(a) of the benefits title to adopt a "wages paid" rule for the calculation of the Social Security wage base. See *id.* sec. 414, § 209(a), 60 Stat. at 990-91. It did so only a few months after *Nierotko* interpreted the "wages paid" benefits-eligibility rule of section 209(g) of that same title to mean that back pay would be "allocated to the periods when the regular wages were not paid as usual," *Nierotko*, 327 U.S. at 370. By using the same "wages paid" language in the amendment of section 209(a) that was already in place in section 209(g), Congress is presumed to have intended the 1946 Act to be interpreted consistently with *Nierotko*. *Cannon* v. *University of Chicago*, 441 U.S. 677, 696-99 (1979) (when Congress uses identical language from a prior statute in a later enactment, it is presumed to intend that judicial interpretations of the prior statute will apply); *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 554, 562 (1991). Surely the Government cannot contend that, after the 1946 Act, "wages paid" meant different things in subsections (a) and (g) of section 209 of the benefits title (Title II) of the Social Security Act.

Because the 1946 Act's amendment of section 209(a) of the benefits title incorporates *Nierotko*'s "wages paid" interpretation, so too does the 1946 Act's amendment of the tax titles. The House Report specifically states that Congress used the identical "wages paid" language in the 1946 Act to amend the definition of FICA and FUTA "wages" in the tax code to "*conform*[] with the changes in section 209(a) of title II of the Social Security Act," H.R. Rep. 79-2447, at 35 (1946) (emphasis added). This puts to rest whatever remains of the Government's argument that a different rule should apply to the tax and benefit titles. As the Sixth Circuit properly held in *Bowman* and the decision below, *Nierotko*

governs the assessment of taxes on back pay awards. 824 F.2d at 530. "Wages paid" has a single meaning throughout the tax and benefits titles of the Social Security Act. Back pay "wages" are deemed "paid" for purposes of the employer FICA and FUTA taxes, 26 U.S.C. §§ 3111, 3301, in the period when they should have been paid. Given that wages are received when paid, 26 C.F.R. § 31.3121(a)-2(a), such wages are deemed "received" for purposes of the employee FICA tax, 26 U.S.C. § 3101, in the period when they should have been received.

D. The Government's Argument That The Tax And Benefits Titles Are Not To Be Construed *In Pari Materia* Is Contrary To The Act's Structure And History And The Government's Prior Arguments To This Court.

The Government's second argument for distinguishing *Nierotko* is that the Social Security benefit provisions should not be construed *in pari materia* with the Social Security tax provisions. U.S. Br. 28-29 (arguing that the "Social Security Administration is a different agency, implementing a different statutory scheme" (internal quotation marks omitted)). But that is the exact opposite of the position it took in 1945, a year much closer in time to the 1939 Act. Then it argued (correctly) that the "wages paid" language in the Title II benefits amendments of the 1939 Act was used "advisedly" and had exactly the same meaning as the "wages paid" language in the Title VI tax amendments that is at issue now in this case. U.S. *Nierotko* Br. 13. Accordingly, if faithful to its earlier position, the Government would concede that *Nierotko* must control this case. Regardless of the reason for the Solicitor General's unexplained reversal of position, this Court discounts the arguments of the Government when it switches positions. See *Norfolk S. Ry.* v. *Shanklin*, 120 S. Ct. 1467, 1474-76 (2000).

In any event, the Government's prior view of the relationship between the "wages paid" language in the

benefits and tax titles of the 1939 Act is clearly correct. "The normal rule of statutory construction assumes that '"identical words used in different parts of the same act are intended to have the same meaning."'" *Sorenson* v. *Secretary of Treasury*, 475 U.S. 851, 860 (1986) (quoting *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934) (quoting *Atlantic Cleaners & Dyers, Inc.* v. *United States*, 286 U.S. 427, 433 (1932))). This rule was well settled when Congress passed the 1939 Act.

The presumption of identical meaning is strengthened here by the broad and conscious parallelism between the tax and benefits titles of the 1939 Act, which Congress has steadfastly maintained to the present. The substantive definitions of "wages" and "employment" have always been essentially identical for both tax and benefit purposes. *Nierotko*, 327 U.S. at 363; compare 26 U.S.C. § 3121(a), (b) with 42 U.S.C. §§ 409, 410.[12] The same ceiling on wages – which is expressly denominated "the contribution and benefit base" – has always been used for both Social Security taxes and benefits. See 42 U.S.C. § 430; 26 U.S.C. § 3121(a). The benefits and tax titles of the Social Security Act simply cannot be regarded as unrelated schemes, as this Court emphasized in *United States* v. *Silk*, 331 U.S. 704 (1947):

> Employment taxes . . . are necessary to produce the revenue for federal participation in the program of alleviation. . . . As a corollary to the coverage of employees whose wages are the basis for the employment taxes under the tax sections of the social security legislation, rights to benefits payments under federal old age

---

[12] Congress has been vigilant to ensure symmetry in the benefits and tax titles. For example, in 1983, it corrected a disjunction whereby employer contributions to simplified employee pensions (SEPs) were wages for benefits purposes but not for tax purposes by amending the statute to require the same treatment of those contributions in both titles. See H.R. Rep. No. 98-25, at 77 (1983), *reprinted in* 1983 U.S.C.C.A.N. 219, 296.

> insurance depend upon the receipt of wages as employees under the same sections. 53 Stat. 1360, §§ 202, 209(a), (b), (g), 205(c)(1). See *Social Security Board* v. *Nierotko*, 327 U.S. 358. The relationship between the tax sections and the benefits sections emphasizes the underlying purpose of the legislation – the protection of its beneficiaries from some of the hardships of existence.

Id. at 710-11.

The legislative history of the 1939 Act confirms that the tax and benefits titles of the Social Security Act must be construed *in pari materia*. The selection of "wages paid" in a calendar period as a common basis for taxation and benefits reflected Congress's decision to preserve the essential character of Social Security as a solvent "contributory" system of social insurance. The 1939 Act was animated by a desire to accelerate and liberalize benefits by extending them to families of workers and the disabled, but "without increasing the future cost of the old-age insurance system." H.R. Rep. No. 76-728, at 2, 7 (1939); S. Rep. No. 76-734, at 2, 6. Even as it liberalized benefits, however, Congress insisted that "the contributory basis of our old-age insurance system be strengthened and not weakened." S. Rep. No. 76-734, at 2, 6. The House and Senate Reports both stated the philosophy of the 1939 Act as follows:

> By relating benefits to contributions or earnings, contributory old-age insurance preserves individual thrift and incentive; by granting benefits as a matter of right it preserves individual dignity. Contributory insurance therefore strengthens democratic principles and avoids paternalistic methods of providing old-age security. Moreover, a contributory basis facilitates the financing of a social-insurance scheme and is a safeguard against excessive liberalization of benefits as well as a protection against reduction of benefits.

Id. at 6.

More specifically, the Senate Report emphasized the importance of having benefits eligibility relate to the periods in which contributions had been made. The 1939 Act's change to a rule where benefits eligibility is based on wages paid during a certain number of calendar periods "permit[s] a smoother progressive increase in the eligibility requirements as the insurance system matures," which is "essential in order to make certain that the benefits bear a reasonable relationship to contributions and wage loss." *Id.* at 14. In the short run period of transition, the 1939 Act would authorize large benefits to persons who had made limited contributions, but in the long run an individual's benefits would be "reasonably related to contributions and loss of earnings." *Id.*; see also H.R. Rep. No. 76-728, at 13 ("The present law permits persons who are in insured employment for only a short time to receive very large benefits in comparison to their contributions. In order to reduce the cost of paying benefits to these persons who shift between insured and uninsured employment, there have been added [eligibility] provisions to protect the system in future years."). Thus, placing benefits eligibility and tax contributions on a common footing was an essential element of the 1939 Act scheme that remains in effect today.[13]

---

[13] The tax amendments of the 1939 Act had the added virtue of simplifying employer recordkeeping by placing FICA and FUTA taxes on a cash rather than an accrual basis. Existing law had tied payroll taxes to the "wages payable" for service in a calendar year, which Congress feared would "unnecessarily complicate the making of returns and the collection of the taxes in later years when the rate of tax has been increased." H.R. Rep. No. 76-728, at 57; S. Rep. No. 76-734, at 70. The example given was the common instance of lag pay, in which an employee would receive wages in 1943 for services performed in 1942. *Id.* Moreover, the wages-payable rule was problematic "[i]n cases in which remuneration for services of an employee in a particular year is based on a percentage of profits, or on future royalties, the amount of which cannot be determined until long after the close of the year." H.R. Rep. No. 76-728, at 62; S. Rep. No. 76-734, at 75. To avoid unnecessary complexities, Congress

There is thus no basis for distinguishing *Nierotko* in the tax context. Indeed, the Commissioner of Internal Revenue, in a 1946 advisory to tax collectors on the heels of this Court's decision, stated that "the decision of the Supreme Court is controlling for Federal employment tax purposes in determining the status of back pay awarded pursuant to an order of the National Labor Relations Board," given the parallel statutory language in the benefits and tax titles. Mim. 6040, 1946-2 C.B. 155, 155. Nonetheless, in the same notice, the Commissioner, without explanation, failed to require taxes to be collected in compliance with the relation-back holding of *Nierotko* that this Court declared a necessary corollary of interpreting back pay to be Social Security "wages," 327 U.S. at 370, despite the parallel "wages paid" statutory language in the relevant tax and benefits sections. See *id.* The IRS's current position perpetuates this unreasoned approach.

E. The *Nierotko* Rule Does Not Resurrect The "Wages Payable" Rule Abandoned In The 1939 Act.

The Government also claims that recognition of the *Nierotko* rule would constitute a return to the "wages payable" rule of the 1935 Act, and frustrate the 1939 Amendments by making tax rates depend on the year in which service is performed. See, *e.g.*, U.S. Br. 9, 35. This argument again reflects the Government's misunderstanding of *Nierotko*.

The relation-back principle adopted in *Nierotko* is a constructive rule specific to *back pay* for determining when wages are "paid"; it requires that the back pay be "allocated

---

amended the tax titles to base the tax on "the rate in effect at the time that the wages are paid and received without reference to the rate which was in effect at the time the services were performed." H.R. Rep. No. 76-728, at 58; S. Rep. No. 76-734, at 71. This aspect of the legislative history is discussed *infra* at 40.

to the periods when the regular wages *were not paid as usual*." 327 U.S. at 370 (emphasis added). It says nothing about the time when services are performed, or when wages are "payable," for indeed this Court was construing a provision – section 209 (g) of the 1939 Act – that made benefits eligibility depend only on when wages are "paid."

The Government is simply mistaken in arguing that *Nierotko* would require taxes to be assessed based on the year in which services were performed. Take the example from the Treasury regulations where an employee is paid $1,000 in 1973 for services performed in 1972. 26 C.F.R. § 31.3101-2(c). In the ordinary course, under the 1939 Act, taxes are assessed at rates in effect in 1973 (the year of payment) and not 1972 (the year of service). *Id.* The same is true under *Nierotko*. If the employee had been unlawfully denied that $1,000 and then had received that amount in a back pay award in 1980, she would be taxed at the 1973 rates (the year in which she should have been paid), not the 1972 rates (the year of service). Contrary to the Government's claims, U.S. Br. 14-19, 23-24, the *Nierotko* rule is thus fully in keeping with the legislative history of the 1939 and 1946 Acts, which require taxes to be assessed "without reference to the rate which was in effect at the time the services were performed." H.R. Rep. No. 76-728, at 58; S. Rep. No. 76-734, at 71.[14]

By returning to the *status quo ante* and assessing taxes at the rate at which they would have been assessed but for the employer's wrongful act (*i.e.*, the rate at the time of regular payment), the *Nierotko* rule does nothing more than make both the employee and the Government whole without penalizing the employer (because FICA and FUTA taxes are

---

[14] Despite the Government's claims that its back pay rule is amply supported in the legislative history, it is notable that all of the examples it draws from those sources deal only with year-end or "lag" pay (*i.e.*, wages paid in the current year for services performed in a prior year). U.S. Br. 14-19, 23-24.

not penal in nature). It is simply a rule that gives the Social Security tax statutes their intended effect. Indeed, back pay for a given year has nothing to do with "wages payable," which refers to remuneration that the employee has earned in a certain year but as to which "no obligation to pay it existed in that year." S. Rep. No. 76-734, at 75. Back pay instead restores that which the employer was obligated to pay an employee in a given year so that the employee is "made whole." *Phelps Dodge Corp.* v. *NLRB*, 313 U.S. 177, 196 (1941).

There is nothing unusual in this Court's adoption of a constructive rule to ensure that a statute operates consistently with its purposes in exceptional circumstances. Although clearly within the ambit of the statute, back pay has always constituted a tiny fraction of the amount of wage payments covered by the Act.[15] The *Nierotko* rule is not different in kind from the constructive payment rules that the IRS has adopted under FICA and FUTA to effectuate the purposes of the statute in other anomalous circumstances.[16] Nor is it different in kind from this Court's repeated recognition of constructive rules to effectuate the purposes of the income tax legislation, where broad rules must be interpreted to fit multifarious circumstances in keeping with the purposes of the Act. For example, in *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84 (1934), this Court deemed the United States Government a "resident" of the United States for tax purposes, and thus held that interest paid to an alien

[15] *Compare Nierotko*, 327 U.S. at 360 n.4 (the NLRB made back pay awards to about 30,000 employees in 1939-45) *with* H.R. Rep. 76-728, at 4 (Social Security wages reported for 32,000,000 employees in 1937-38).

[16] By regulation, wages are deemed "constructively paid" or "received" if it is within the power of the employee to reduce the money to possession, even if he is not actually paid at that time. 26 C.F.R. § 31.3121(a)-2(a), (b). The IRS has also adopted specific regulations as to when "cash remuneration" will be deemed paid within a calendar quarter. *Id.* § 31.3121(a)-2(c).

corporation on a federal tax refund could be taxed as "'interest on . . . interest-bearing obligations of residents.'" *Id.* at 86, 92. The Court declared that "a contrary holding would defeat the evident purpose of [the] statute." *Id.* Deeming the Government a "resident" "may be in the nature of a legal fiction," the Court stated, "but legal fictions have an appropriate place in the administration of the law when they are required by the demands of convenience and justice." *Id.*[17]

Similarly, this Court has recognized that "[a]s the federal social security legislation is an attack on recognized evils in our national economy, a constricted interpretation of the phrasing by the courts would not comport with its purpose," and would "invite adroit schemes by some employers and employees to avoid the immediate burdens at the expense of the benefits sought by the legislation." *Silk*, 331 U.S. at 712 (construing definition of taxable "employment"). *Nierotko* is squarely within this tradition. It is not a departure from the plain language but a construction of it in an exceptional circumstance to ensure that benefits are credited and taxes assessed in keeping with the purposes of the Act.

Nierotko is thus controlling precedent on the meaning of "wages paid" language in the Social Security Amendments of

[17] *Cf. Hillsboro Nat'l Bank* v. *Commissioner*, 460 U.S. 370, 377 (1983) (describing the tax-benefit rule as "a judicially developed principle that allays some of the inflexibilities of the annual accounting system") (footnote omitted); *Commissioner* v. *Court Holding Co.*, 324 U.S. 331, 334 (1945) (attributing a gain from sale of an asset to a corporation, rather than the actual seller, in order to promote "the effective administration of the tax policies of Congress"); *Douglas* v. *Willcuts*, 296 U.S. 1, 9 (1935) (discharge of taxpayer's debt by another is income "received" because it is "regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor"); *Helvering* v. *F. & R. Lazarus & Co.*, 308 U.S. 252, 255 (1939) (rejecting Commissioner's literal interpretation that the statutory right to depreciation follows legal title, and looking to the substance of a transaction to determine tax liability).

1939, as applied to back pay. The Government does not ask this Court to overrule *Nierotko*, and (mistaking the statutory basis for its holding) advances no coherent basis for distinguishing it. The Government never explains the fundamental inconsistency in its position that it accepts the *Nierotko* relation-back principle for determining the taxability of "wages" under the statute, cf. 327 U.S. at 360, but not for determining the rate of tax, cf. *id.* at 370. This Court does not lightly depart from a precedent that underlies a complex regulatory system and concerns a statute that has been the subject of frequent attention from Congress without contrary amendment. *California* v. *FERC*, 495 U.S. 490, 499 (1990). The Government has given this Court no reason to question the continuing validity and applicability of *Nierotko*.[18]

---

[18]Although employment and income tax are separate regimes, *cf.* 26 U.S.C. §§ 3121(a), 3306(b) (indicating that the definition of "wages" in income tax provisions is not controlling for FICA and FUTA purposes), the *Nierotko* rule is fully consistent with the treatment of back pay for income tax purposes at the time of the 1939 and 1946 Acts. A few months prior to the 1939 Act, Congress enacted section 107 of the Internal Revenue Code to deal with the situation in which compensation is paid upon completion of work that is performed over an extended period (5 years or more). Congress eliminated any tax penalty for the delay of payment, providing that "the tax attributable to such compensation shall not be greater than the aggregate of the taxes attributable to such compensation had it been received in equal portions in each of the years included in such period." Revenue Act of 1939, ch. 247, § 220a, 53 Stat. 862, 878. In 1943, in an amendment applicable to tax years from 1941 onwards, Congress created a new subsection (d) of section 107 to address the specific circumstance of back pay. It provided that, where back pay exceeded 15% of gross income in a taxable year, the tax imposed upon such back pay "shall not be greater than the aggregate of the increases in the taxes which would have resulted from the inclusion of the respective portions of such back pay in gross income for the taxable years to which such portions are respectively attributable" according to Treasury regulations. Revenue Act of 1943, ch. 63, sec. 119(a), § 107(d), 58 Stat. 21, 39. In justifying its relation-back holding against claims of administrative difficulty, this Court in *Nierotko* specifically noted that back pay was "treated distributively" under the Revenue Act of 1943. 327 U.S. at 370 n.26; sec. 119(a), § 107(d), 58 Stat. at 39. There is no reason to infer that Congress, in the 1939 and 1946 amendments to the Social Security Act, did not intend a similar distributive taxation of back pay under FICA and FUTA to avoid any tax penalty befalling the injured employee.

II. THE GOVERNMENT'S RULE IS INCONSISTENT WITH THE PLAIN LANGUAGE OF THE STATUTE AS A WHOLE AND ITS PURPOSES.

The foregoing section demonstrates that, even if statutory analysis is confined to the "wages . . . paid" and "wages . . . received" clauses in 26 U.S.C. §§ 3101, 3111, and 3301, the Government's proposed rule is unsound. But this Court has admonished that "[w]e do not . . . construe statutory phrases in isolation; we read statutes as a whole." *United States* v. *Morton*, 467 U.S. 822, 828 (1984); *Bailey* v. *United States*, 516 U.S. 137, 145 (1995); *King* v. *St. Vincent's Hosp.*, 502 U.S. 215, 221 (1991). "Statutory construction . . . is a holistic endeavor" directed to determining which among "permissible meanings produces a substantive effect that is compatible with the rest of the law." *United Sav. Ass'n* v. *Timbers Of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988). Thus, the meaning of a tax statute, like any other, "'is to be ascertained, not by taking the word or clause in question from its setting and viewing it apart, but by considering it in connection with the context, the general purposes of the statute in which it is found, the occasion and circumstances of its use, and other appropriate tests for the ascertainment of the legislative will.'" *Commissioner* v. *Wodehouse*, 337 U.S. 369, 379 (1949) (quoting *Stockholm Enskilda Bank*, 293 U.S. at 93).

A. The Government's Rule Is Inconsistent With The Rational Operation Of Other Statutory Provisions.

The Government's back pay rule cannot be reconciled with the statute as a whole. The tax provisions of the Social Security Act (FICA and FUTA) are reticulated schemes in

which Congress has carefully defined what types of wages or employment are subject to taxation. Both historically and in the present, the statute has frequently defined the taxability of wages or employment based on some event or status at the time of *payment:* Treating wages as "paid" at the time of the back pay award leads to manifestly absurd results that defeat the statutory purpose. Under the Government's rule, wages that were never meant to be taxed become taxable, and wages that would have been taxed are exempted – thus rewarding the employer for its wrongdoing. Adherence to *Nierotko* would avoid these absurd results. See *Haggar Co.* v. *Helvering*, 308 U.S. 389, 394 (1940) (rejecting Government's mechanical reading of a statute governing amended returns, noting that "[a] literal reading of [statutes] which would lead to absurd results is to be avoided when they can be given a reasonable application consistent with their words and with the legislative purpose"); *Green* v. *Bock Laundry Mach. Co.*, 490 U.S. 504, 527 (1989) (Scalia, J., concurring in the judgment).

1. Definition of Taxable "Wages"

Congress has defined taxable wages as "all remuneration for employment," 26 U.S.C. § 3121(a), but also has declared numerous exemptions for policy reasons. *Id.* § 3121(a)(2)-(21). Because the taxability of wages depends frequently on an event or status at the time of payment, the Government's proposed back pay rule has nonsensical results. Among the many examples that could be listed are the following:

Sickness or Accident Disability Benefits. Congress has excluded from "wages" "any payment on account of sickness or accident disability," including coverage of medical and hospitalization expenses, made by an employer to an employee "after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer." *Id.* § 3121(a)(4). This provision was added to cover payments that are not under a general disability plan, which are addressed by section 3121(a)(2).

See S. Rep. No. 81-1669 (1950), *reprinted in* 1950 U.S.C.C.A.N. 3287, 3424. The six-month period is meant to distinguish wages from true gratuities or disability benefits. A back pay award may encompass the failure to pay sickness and accident payments actually owed to an employee, including short-term sick pay or disability benefits or any medical or hospital expenses during the course of employment. Under the Government's rule, all such payments would be exempt from tax if the employee has not worked for the employer for at least six months prior to the *back pay* award. Congress did not intend for this provision to operate in such a fashion, and the Government's rule supplies nothing more than a windfall for the wrongdoing employer – and indeed an incentive for the employer to engage in wrongdoing – that would be averted by application of the *Nierotko* rule. See *Maximov* v. *United States*, 373 U.S. 49, 56 (1963) (interpreting tax treaty to "prevent[] an unintended tax windfall to a private party"); *Libson Shops, Inc.* v. *Koehler*, 353 U.S. 382, 389 (1957) (same regarding federal tax statute).

Retired Judges. Retired federal judges and justices continue to receive the salary of their office so long as they perform judicial or administrative service that satisfies minimum statutory requirements. 28 U.S.C. § 371(b), (f). A retired judge or justice may also on occasion accept an assignment to active duty. See *id.* § 294. If a retired judge or justice performs judicial service on assignment to active duty, Congress has exempted from FICA taxation any salary payment "which is received during the period of such service." 26 U.S.C. § 3121(i)(5). In other words, salary payments to retired judges and justices are subject to FICA except during the period of active-duty service. Under the Government's rule that treats back pay as "paid" or "received" at the time of the award, a retired federal judge or justice who receives a back pay award covering active-duty service after service is complete must pay the full amount of FICA tax. This is contrary to the clear congressional intent

that such compensation should be untaxed. Under the *Nierotko* rule, the payment would be deemed to relate back to the period of service, and the absurdity would be avoided.

Payments To Estates Or Survivors. Congress has exempted from FICA tax "any payment made by an employer to the survivor or the estate of a former employee after the calendar year in which such employee died." 26 U.S.C. § 3121(a)(14). The reason for the exemption is that qualification for, and the amount of, Social Security survivor benefits are calculated only on the basis of wages paid through the calendar quarter (or year) of death. Cf. 42 U.S.C. §§ 413(a)(2), 415(b). Given the fundamental policy of the Act that benefits be "reasonably related to [tax] contributions," S. Rep. No. 76-734, at 14, Congress created this exemption because it would be unfair to tax wages that do not count for benefits purposes. S. Rep. No. 92-1230, at 29 (1972).

Under *Nierotko*, back pay wages received after the employee's death are deemed "paid" in "the periods when the regular wages were not paid as usual." 327 U.S. at 370. Thus, the "wages" would be deemed "paid" in the calendar periods prior to death, and would count for benefits purposes. This is one of the most important applications of *Nierotko*. Without the relation-back principle of *Nierotko*, surviving widows and children, whose needs are often acute, could lose benefits altogether (or have benefits substantially reduced) because of the employer's wrongdoing.

The Government's proposed rule destroys the parity between benefits and taxes that Congress sought to maintain with this exemption. Under the Government's misguided rule, no tax is assessed on the back pay wages, even though the crediting of those wages under *Nierotko* obligates the Government to pay higher benefits. Moreover, the Government's rule perversely transforms this exemption into an unjustifiable windfall for the wrongdoing employer, who is relieved from FICA tax liability simply on the happenstance

that the employee dies in the (often long) intervening period before back pay is awarded.

The 1994 arbitrator's award directly implicates this exemption. Two players who received substantial back pay awards for 1986 and 1987 – Donnie Moore and Rod Scurry – died tragically in 1989 and 1992, respectively. Under the Government's rule, the clubs for whom they played in 1986 and 1987 are not liable for any tax on the payment to their estates because the back wages were "paid" in a calendar year after they died (1994). It is irrational to interpret the statute to treat back pay to Moore and Scurry for playing baseball in 1986 and 1987 any differently from that awarded to other players. This situation may arise frequently, for example, when elderly employees sue for back pay under the Age Discrimination In Employment Act.

2. Definition of Taxable "Employment"

Congress also has historically tied the taxability of certain employment relations to the amount of remuneration paid. For example, in the 1939 Act, services performed for a tax-exempt organization in a calendar quarter were exempt from FICA and FUTA tax if the remuneration did not exceed $45 *in that quarter*. 1939 Act, sec. 606, § 1426(b)(10), 53 Stat. at 1384-85. Service by a student employee of any school, college, or university was also exempt if the wage did not exceed $45 (after room, board, and tuition) in the quarter when the service was performed. *Id.* at 1385. In 1950, Congress also exempted agricultural labor and service not in the course of the employer's trade or business unless quarterly wages were at least $50 *and* the employee was regularly employed by the employer in that quarter. Social Security Act Amendments of 1950, ch. 809, sec. 204(a) § 1426(b), 64 Stat. 477, 528-29.[19]

---

[19] In 1939, the average annual wage for workers in all industries was only $1,266 (about $316 per quarter). *The Value Of A Dollar, 1860-1999,*

The Government does not apparently contest that, in determining the taxability of employment, a court must look back to the period for which the back pay was awarded and determine whether the services that would have been performed were covered by a statutory exemption. Cf. 26 U.S.C. §§ 3121(b), 3306(c). For provisions where the taxability of employment depends on the amount of remuneration paid in a quarter of service, however, the Government's rule makes no sense. Take, for example, a regularly employed agricultural laborer who was to have been paid $3,600 per year ($900 per quarter). Those wages, which were within the 1950 wage base, would thus have been subject to tax. Cf. 1950 Act, § 203(a), 64 Stat. at 525 (wage ceiling of $3,600). The laborer is unlawfully terminated in 1951. He wins a $7,200 back pay award in 1955 covering the years 1952 and 1953. Under the *Nierotko* rule, the back pay is attributed back to the quarters he would have worked, and the employer properly would owe tax on those wages. Under the Government's rule, however, the wrongdoing employer would avoid the tax because there would be no quarter of service in which the employee is *both* (1) paid wages of $50 or more *and* (2) regularly employed by that employer. See 26 U.S.C. § 3306(c). In other words, under the Government's rule, the *employment relation itself* would become nontaxable simply because of the timing of the back pay award.

Conversely, it would be absurd if employment that is tax-exempt (*e.g.*, agricultural, student, or nonprofit labor where wages were only $40 per quarter) became taxable simply because a back pay award aggregated multiple quarters. The Government's rule thus cannot be a viable interpretation of the 1939 Act. The Social Security Act is predicated on wages paid for employment in the ordinary course, and the *Nierotko* rule is necessary for its rational operation in the unusual circumstance of a back pay award.

---

at 207 (Scott Derks ed., 1999). The average annual wage for farm labor was $436 in 1939 and $1,454 in 1950. *Id.* at 207, 278.

3. Definition of a Taxable "Employer"

The Government's rule also makes nonsense of the Act's definition of an "employer" subject to FUTA. FUTA defines an "employer" subject to tax based on (1) the amount of "wages" that are "paid" "during any calendar quarter" of the current or prior "calendar year," or (2) the number of days in a current or prior "calendar year" in which he has employed at least one individual. 26 U.S.C. § 3306(a)(1). The wages-paid prong of the test was not added until 1970, and the legislative history of that amendment makes clear (as does the statutory text) that both prongs refer to the same "taxable year or the preceding taxable year." H.R. Conf. Rep. No. 91-1037 (1970), *reprinted in* 1970 U.S.C.C.A.N. 3646, 3646. It would plainly be absurd, as the Government's rule requires, for an employer's FUTA liability to depend on the number of days in which a person had employed any individual in the year of (or prior to) the *back pay award*.

Moreover, the specific statutory definition of an "agricultural employer" demonstrates the unsoundness of the Government's position. An agricultural employer is a statutory "employer" liable for unemployment tax only if he (1) "during any calendar quarter in the calendar year or the preceding calendar year paid wages of $20,000 or more for agricultural labor" or (2) employed 10 or more individuals on some portion of 20 days in the current or preceding calendar year. 26 U.S.C. § 3306(a)(2). First, assume a farmer paid $100,000 total in qualifying agricultural wages in a calendar quarter in 1990 (and thus is an agricultural employer under FUTA in 1990), but reneged on an additional $10,000 that should have been paid to certain employees and that would have been subject to FUTA tax. He pays a back pay award of $10,000 in 1993, but in that year and the year prior he does not pay enough agricultural wages or hire enough laborers to meet the statutory test of an "agricultural employer." Under the Government's rule, he escapes tax by virtue of his

wrongdoing. Under *Nierotko*, the wages would be deemed paid in 1990, and he would pay the applicable taxes.

Second, assume the same facts except that the 1993 back pay award is in the amount of $50,000. The farmer enters into a settlement with the employees to spread the $50,000 back pay over four quarters in 1993, thus escaping unemployment tax altogether under the Government's rule because again he would not have met the threshold of quarterly wages (at least $20,000) to qualify as an "employer" in the year of the back pay award. Here, too, the wrongdoer avoids taxation that he should have paid but for his illegal conduct. Under *Nierotko*, the $50,000 award would relate back to 1990, and would be taxed as it would have been absent the wrongful acts.

The Government's rule, unlike the *Nierotko* rule, is thus subject to strategic manipulation. This Court should not adopt a rule where certain employers (if they are under the wage cap with regard to particular employees) have incentives to create or prolong wage disputes so that taxation might be reduced in amount or eliminated altogether. See *United States* v. *Silk*, 331 U.S. 704, 712 (1947). Under the *Nierotko* rule, an employer, whether under the wage cap or not, never has a tax incentive to create wage disputes because the tax always relates back to the year when the wages should have been paid.

In sum, the entire statutory structure of the Social Security Act (both in terms of benefits and taxes) is predicated on wages that are paid in the ordinary course as remuneration for employment. The *Nierotko* relation-back rule is not only essential for the equitable treatment of back pay, but also it is the only rule that "produces a substantive effect that is compatible with the rest of the law." *United Sav.*, 484 U.S. at 371. Under the Government's rule, in a number of circumstances, an employer is rewarded for wrongdoing by relief from FICA and FUTA taxation, or an employee is subject to FICA tax that would never have been imposed but

for his employer's wrongdoing. Such anomalies do not arise in the ordinary course of employment, whether wages are paid in the year of service or as "lag pay" thereafter. Because *Nierotko* alone makes sense of the statute as a whole in the context of back pay, see *United States* v. *Williams*, 514 U.S. 527, 534 (1995) (rejecting Government's interpretation as "inconsistent with other provisions" of the tax statute), Congress presumptively relied upon it in later enacting the statutory provisions detailed above. *Cannon*, 441 U.S. at 696-99.

B. The Government's Rule Is Inconsistent With The Nature of FICA and FUTA As Excise Taxes On The Employment Relation.

The Government's rule is antithetical to the plain language of the statute and this Court's precedent in another respect. By its express terms, Congress imposed the old-age and unemployment taxes on employers as "an excise *upon the employment relation*." *Charles C. Steward Mach. Co.* v. *Davis*, 301 U.S. 548, 578 (1937) (FUTA) (emphasis added); *Helvering* v. *Davis*, 301 U.S. 619, 645 (1937) ("The tax upon employers is a valid excise or duty upon the relation of employment.") (FICA).[20] Those taxes are not imposed on the act of paying wages; rather, as both the statute and the Treasury regulations make clear, "wages paid" during a calendar year is merely the "measure of the tax." 26 C.F.R. §§ 31.3111-1, 31.3301-2; see also 26 U.S.C. § 3111 (imposing excise tax on employment "equal to the following percentages of wages . . . paid by him with respect to employment" for specified years); 26 U.S.C. § 3301 (same).

---

[20] 26 U.S.C. § 3111 ("there is hereby imposed on every employer *an excise tax, with respect to having individuals in his employ*") (emphasis added); *id.* §3301 ("[t]here is hereby imposed on every employer (as defined in section 3306(a)) for each calendar year *an excise tax, with respect to having individuals in his employ*") (emphasis added). *Cf. id.* § 3101 (income tax on employees at a rate determined by the wages "received by him with respect to employment").

This Court in *Steward* held that it was constitutional for Congress to tax the employment relation, given that employment was historically subject to excise taxes, and the constitutional authority to impose excise taxes under Article I, Clause 1 was not limited by the nature of the activity. *Charles C. Steward Mach. Co.*, 301 U.S. at 579-82; *Helvering* v. *Davis*, 301 U.S. at 645. Because these are excise taxes on the employment relation, this Court should not interpret the statute to subject identical employment relations to widely varying and inequitable tax burdens based on arbitrary factors.

In the ordinary course of employment, the "wages paid" rule of FICA and FUTA creates no inequity and no penalty to the public fisc. If rates are constant from one year to the next, there is generally no tax effect, because the wages that carry over into the 2000 tax year will generally be offset by those that carry over into the 2001 tax year. Even if the rates increase in the next year, the effect on the ordinary wage earner with carryover wages is minimal.[21] This is in full accord with the legislative history indicating that the "wages paid" rule was adopted as a means of simplifying employer recordkeeping. See *supra* 25-26 n.13. Moreover, there is no structural unfairness in the wages-paid rule; the wage earner would benefit from any tax decrease in a subsequent year (although historically those have not occurred). Circumstances could arise in which the timing of wage payments could have substantial tax effects: for example, where a large bonus is to be paid in 2000 for services performed in 1999 by an employee who is retiring or otherwise terminating his employment with the employer at the end of 1999. But both the employer and the employee have an incentive to

[21] The largest single-year increase in the Social Security (OASDI) tax rate since 1955 was 0.5 percent (in 1960 and 1963). *The 2000 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* 34-35 (Table II.B.1) (2000) ("*2000 OASDI Trustees Report*").

anticipate situations of this kind. Employers and employees thus may structure payment terms (quite legally) to avoid tax anomalies, for example, by accelerating payment to the year of service.

By contrast, the Government's rule results in arbitrary and inequitable taxation of the same employment relation, either to the detriment of the employee and the employer or of the Government. As shown in section II, in many circumstances whether a given employment relation would be taxed at all would depend solely on the timing of the back pay award, contrary to any rational interpretation of the statute. Moreover, the Government's rule may force the injured employee to pay employment taxes twice – often at a higher rate and on a larger part of his wages – simply because of the wrongdoing of his employer.

This case vividly illustrates that inequity. Fifteen former players for the Cleveland Indians who received an award of back pay for 1987 (and eight for 1986) paid the maximum Social Security and Medicare taxes in that year. If they had not been injured by the collective action of the clubs, and had received the additional salary in those years, they would have owed no additional tax. But because of the clubs' wrongdoing that resulted in a back pay award in 1994, all the players who received awards paid federal employment taxes again (and all but one of them paid the maximum in 1994, at higher rates and on a much higher wage base). See *supra* at 4. Cf. *United States* v. *Supplee-Biddle Hardware Co.*, 265 U.S. 189, 195-96 (1924) (constructions of statutes to impose a double tax should be avoided "unless required by express words").

Thus, the Government's rule flatly results in inequitable treatment of identical employment relations where the payment structures were the same. Pitcher A who made $200,000 (or $2 million) in 1987 that is fully paid in that year ends up paying less than half of the tax paid by Pitcher B, who should have been paid $200,000 in 1987, but ends up

receiving $100,000 in 1987 and $100,000 in back pay in 1994 solely because of his employer's wrongful act. This is simply an irrational operation of an employment tax.

Similarly, despite having paid the maximum federal employment taxes on all the players in 1986 and 1987, respondent likewise paid the employer's FICA and FUTA taxes a second time in 1994, at higher rates and on a higher wage base, even though it would have owed no tax had the salaries been properly paid in 1986 or 1987. That double taxation is inequitable and contrary to the statutory scheme, which imposes an excise tax and *not* a penalty.[22] Cf. *Lipke* v. *Lederer*, 259 U.S. 557, 562 (1922) (distinguishing between a tax, which is meant for support of the government, and a penalty, which punishes infractions of the law).

The Government tries to counter the inequity and irrationality of its rule by claiming that "taxing back wages in the year actually paid does not routinely result in additional FICA and FUTA tax liability," and that "less tax would be owed" if the employee had already reached the maximum wage ceiling in the year of the award. U.S. Br. 29 (emphasis omitted). Even if that is true in some cases, the Government's rule harms many classes of vulnerable plaintiffs – namely, retirees, the disabled, or victims of age, race, or sex discrimination – who frequently are not able to secure subsequent employment, or replacement employment at wages anywhere near the annual wage ceiling (which in

---

[22] The arbitrariness of the Government's rule is heightened by the fact that federal tax liability will depend on how and when a court or arbitrator makes a back pay decision. If the arbitrator had issued the 1986 salary award in 1994, and the 1987 award in 1995, the employees receiving payments under those awards and respondent would have paid FICA and FUTA taxes again (in most cases, at the maximum amount). Moreover, the arbitrator did make a separate award in 1995 for loss of *nonsalary* benefits in 1986 and 1987. *See supra* at 2 n.2. If the Government succeeds in taxing those awards as wages, respondent and its employees will in effect be triple taxed for the same employment relation.

2001 is $80,400, 65 Fed. Reg. 63,663, 63,663 (2000)). Such an outcome would be particularly inequitable given that back pay awards of this kind "are for the 'protection of the employees and redress of their grievances' to make them 'whole.'" *Nierotko*, 327 U.S. at 365. And the Government's rule will generally be harmful to employer taxpayers in the common case where an individual who wins a back pay award no longer works for the company. As here, the employer will pay the full amount of taxes in the year of the back pay award, no matter what was paid previously. Finally, given the modern trend, all such employees and employers will typically be forced to pay taxes at higher rates and/or on a larger amount of wages.

More importantly, the fact that some taxpayers receive a windfall (by being relieved of tax that would have been paid but for the employer's wrongdoing) is hardly a defense of the Government's rule. There is no reason why this Court should interpret the statute to allow a wrongdoing employer, who should have paid FICA and FUTA taxes in each of the five years covered by a back pay award, to pay only one year's worth of tax in the year of the back pay award. Indeed, that employer may pay no tax at all on the back pay if in the year of the award it has already paid the employee substantial wages for current employment.

A rule that creates potential tax windfalls of this kind will only "invite adroit schemes by some employers and employees to avoid the immediate burdens at the expense of the benefits sought by the legislation." *Silk*, 331 U.S. at 712. For example, an employer who is under the wage ceiling with respect to a certain employee (or class of employees) in a given year may decide to deny overtime pay, knowing that even if it is eventually held liable for back pay, it may have significantly reduced or eliminated tax liabilities for those years (*e.g.*, by deferring multiple years of back pay to a single year with the result that total wages in the calendar year will exceed the wage ceiling). Under *Nierotko*, by contrast, an

employer never has an incentive to create or prolong a wage dispute, regardless of whether wages are below or above the statutory ceiling. Taxation will always relate back to the year in which the taxes should have been paid. 327 U.S. at 370. That is clearly the only viable interpretation of the statute.

Finally, the Government's position is indefensible because it is contrary to the funding scheme of the Act. As discussed above, *supra* at 23-25, by placing taxation and benefits on a common basis in the 1939 Act, Congress created a scheme whereby an individual's benefits would be "reasonably related to contributions and loss of earnings." S. Rep. No. 76-734, at 14. Because the SSA continues to apply *Nierotko* in regard to benefits,[23] where an award covers multiple years of back wages, an individual will receive multiple years of credit towards benefits, but the Government collects only one year of tax (or perhaps none at all).

Although the Government is dismissive of that concern in this litigation, it has previously recognized that such a result is fiscally unsound. In a 1976 General Counsel Memorandum, the IRS decided to treat back pay based on an unlawful failure to hire as "wages" in order to maintain parity

---

[23] The Government emphasizes that the SSA has, as a matter of policy, limited *Nierotko* to "'back pay under a statute,'" without explaining the source of the SSA's discretion to constrict this Court's precedent. U.S. Br. 28 n.15 (citing SSA, Dep't of Health & Human Servs., SSR 83-7, 1981-1991 Soc. Sec. Rep. Ser. 18 (1983)). Although the SSA's policy is not directly at issue here, it is flatly inconsistent with *Nierotko*. Nothing in the text of the Social Security Act or *Nierotko* suggests that back pay under a statute is different from other kinds of back pay. *Nierotko* did rely on specific provisions of the National Labor Relations Act in determining whether an NLRB back pay award was "wages" within the meaning of the Act, 327 U.S. at 364-65, but that analysis is not the basis of the distinction drawn by the SSA. The SSA treats all back pay as wages, but arbitrarily denies retroactive benefits credit to employees if the back pay is not awarded under a statute. *Nierotko*'s relation-back holding, which is a construction of the unqualified "wages paid" language of section 209(g) of the 1939 Act, cannot reasonably be limited to back pay under a statute.

with the SSA and thus "protect[] the fisc." Gen. Couns. Mem. 36,732 (May 19, 1976). The IRS reasoned that, unless it followed the same rule as the SSA, "benefits would be paid without proper funding (by corresponding taxes earlier paid)." *Id.* Likewise here, this Court should not adopt an interpretation of the statute that denies the "proper funding" of future benefits by "corresponding taxes earlier paid," *id.*, a particularly grave concern in an era when the Social Security trust funds are not in actuarial balance, *2000 OASDI Trustees Report*, *supra*, at 3.[24] See *United States* v. *W. M. Webb, Inc.*, 397 U.S. 179, 190-91 (1970) (noting importance to Congress of parity in SSA and IRS treatment of maritime employees so as to avoid "an uncompensated drain on the social security fund"); *United States* v. *Lee*, 455 U.S. 252, 258 (1982) (declaring that "mandatory contributions" are "indispensable to the fiscal vitality of the social security system").

C. The Interpretation Of An Employer's Withholding Obligations In *Otte* Is Irrelevant To The Calculation Of The Tax Owed.

Despite the incongruity of its position with the FICA and FUTA statutes as a whole, the Government attempts to rely on *Otte* v. *United States*, 419 U.S. 43 (1974), in which this Court held that a bankruptcy trustee must withhold FICA taxes from delayed wage payments to former employees who worked for the bankrupt company in past years because the employer is obligated to withhold taxes from wages "'*as and when* paid.'" *Id.* at 51 (quoting 26 U.S.C. § 3102(a)) (emphasis added). *Otte* is a red herring because it involves the FICA collection statute, and is irrelevant to the proper calculation of any employment tax that is imposed on back pay. See *Central Ill. Pub. Serv. Co.* v. *United States*, 435 U.S. 21, 29 (1978) (noting, in case involving the income tax,

---

[24] This Court may rely upon nonprecedential rulings (like the General Counsel Memorandum) in assessing the validity of the Government's position. *Rowan Cos.* v. *United States*, 452 U.S. 247, 261 n.17 (1981).

that considerations of tax liability "are not necessarily the same as the considerations that support withholding").

The withholding statute, by its terms, places a collection obligation upon the employer only *after* the employee FICA tax is calculated under § 3101; its provisions thus do not speak to the basis or rate of taxation, which is the issue here. See 26 U.S.C. § 3102(a) ("The tax *imposed by section 3101* shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid.") (emphasis added).[25] The employer is liable to the United States as a tax collector for the amount it is required to collect, and indemnified from actions by claims from other persons with regard to the amount withheld. *Id.* § 3102(b).

By prescribing that the employee FICA tax be collected from wages "as and when paid," *id.* § 3102(a), Congress has declared that the collection obligation attaches to each act of payment. Collection (and the employer's liability for the employee's tax) cannot occur until an act of payment, because without payment there would be nothing from which to collect the tax, by withholding or otherwise. This same "as and when" language does *not* appear in the rate-of-tax provisions enacted in the 1939 Act that are at issue here. Moreover, this withholding language was in the original 1935 Act, § 802, 49 Stat. at 636, and has always applied no matter what the measure of the tax. It has no bearing on the calculation of any tax that may be owed or the devising of rules for rational operation of the rate-of-tax provisions of the statute.

The Government claims that *Nierotko* would require employers to withhold taxes for back pay in the year of service (before back pay may even have been sought, much less paid!). U.S. Br. 29-30. Such a requirement, the

[25] The employer is obligated to collect the employee's FICA tax by deduction if the wages are in cash, or by direct collection from the employee if they are not. *See* 26 C.F.R. § 31.3102-1.

Government contends, would conflict with *Otte*, which requires withholding at the time of actual payment. *Id.* at 30. The premise of the Government's argument is false, because *Nierotko* has no implications for withholding. *Nierotko* is a rule for determining the rate of tax that does not affect withholding duties – just like, on the benefits side, *Nierotko* is a rule for determining benefits credit that does not affect reporting obligations. The SSA does not nonsensically require an employer to report "back pay" in the year of service; the report is filed when the money changes hands. Social Sec. Admin., Pub. 957, *Reporting Back Pay and Special Wage Payments to the Social Security Administration* 2 (1997). A similar rule would apply for the taxation of back pay, and would be fully consistent with *Otte*.

As to the Government's general argument that *Nierotko* would create administrative burdens, such arguments are of little force when the rule is required for equitable operation of the Social Security laws. 327 U.S. at 370. Regardless, the Government's argument is vastly overstated. Employers are required by law to retain records of Social Security wages and taxes for each employee. 26 C.F.R. §§ 31.6001-2, 31.6001-4. Most importantly, employers *already* allocate back pay to prior years of service in their reports to the SSA for application of *Nierotko*, and having a unified *Nierotko* rule would create no added burden because the same apportionment would be used for tax purposes. Once back pay is apportioned, the calculation of taxes owed is simple. The back pay is added to prior wages for the year in question, the tax is recalculated upon the new wage total (to the extent it is below the wage ceiling for that year) based on the rates in effect in the prior year, and any balance above what had been previously paid would be paid to the IRS. Thus, compared to other tax reporting and accounting requirements imposed on

employers, any additional administrative burden from applying the proper statutory rule is *de minimis*.[26]

III. THE GOVERNMENT'S INTERPRETATION IS NOT ENTITLED TO DEFERENCE.

The Government's claim that the IRS's interpretation of the FICA and FUTA statutes is entitled to deference should also be rejected.

First, the Government's argument that the Treasury regulations reject the *Nierotko* rule for back pay is badly misplaced and founded on the Government's misunderstanding of *Nierotko*. The Treasury regulations do not even address back pay, and (as the Government acknowledges, U.S. Br. at 19 n.10) are substantively unchanged from a period prior to *Nierotko* in which the IRS held a position on back pay that was rejected as "unsound" by this Court. 327 U.S. at 367. Moreover, far from addressing back pay, those regulations stood (and stand now) for the general proposition that the rate of FICA excise tax is measured by "wages paid" in a calendar year, rather than "wages payable." Cf. U.S. Br. 19-20, 24-25 and regulations cited therein. The Government's erroneous claim that *Nierotko* requires taxation on a "wages payable" basis, and thus conflicts with these regulations, see *id.*, again stems from its fundamental failure to recognize that *Nierotko* is a construction of a "wages paid" statute as applied to back pay, not a revival of the "wages payable" rule. Because the regulations are silent as to when remuneration in the form of back pay is considered "paid" for

---

[26] The administrative burdens of applying *Nierotko* are far less than the burdens of administering the elaborate rules for FICA and FUTA taxation of nonqualified deferred compensation plans, which require deferred amounts to be taxed in the later of the year when services are performed or when there is no substantial risk of forfeiture, 26 U.S.C. § 3121(v)(2)(A). *See* 26 C.F.R. § 31.3121(v)(2)-1. Congress has required these burdens to avoid tax inequity and gamesmanship that would result from the deferral of taxation to the year when such compensation would actually be paid.

tax purposes, that leaves this Court's opinion in *Nierotko* as the long-standing, unchanged authority on this issue. If Congress is to be deemed to have approved of an interpretation of the FICA and FUTA rules concerning back wages, it should be this Court's interpretation, not that put forth by the IRS. *Cottage Sav. Ass'n* v. *Commissioner*, 499 U.S. 554, 562 (1991) ("[B]ecause Congress has left undisturbed through subsequent reenactments of the Code the principles of realization established in these cases, we may presume that Congress intended to codify these principles."). *Nierotko* is a "wages paid" rule for the exceptional circumstance of back pay that is not addressed in the regulation, and is fully consistent with the regulation.

The IRS has issued more specific guidance addressing the taxation of back pay, but it has taken the form of revenue rulings, not regulations. See U.S. Br. 20 (citing, *e.g.*, Rev. Rul. 89-35, 1989-1 C.B. 280). Agency interpretations of this nature, which do not benefit from the reflection and discourse provided by notice-and-comment procedures or adjudications, are not entitled to deference under *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984), because they do not have the force and effect of law. *Christensen* v. *Harris County*, 120 S. Ct. 1655, 1662 (2000); *Bartels* v. *Birmingham*, 332 U.S. 126, 132 (1947) (revenue rulings "do not have the force and effect of Treasury Decisions"); *United States* v. *Swank*, 451 U.S. 571, 579 & n.13 (1981) (rejecting IRS interpretation of statute and regulation that was embodied in a revenue ruling).

In any event, whether it is acting through a regulation or ruling, the IRS lacks the authority to interpret a statute in a manner that conflicts with a prior interpretation by this Court. *Maislin Indus.* v. *Primary Steel, Inc.*, 497 U.S. 116, 130-31 (1990); *Neal* v. *United States*, 516 U.S. 284, 295 (1996). In such circumstances, the prior ruling by the Court is controlling under the doctrine of stare decisis and any agency interpretation to the contrary should be disregarded. *Id.* Even

if *Nierotko* were not controlling, it would at least be incumbent upon the IRS to distinguish it based on a proper conception of the statutory basis for the decision. Instead, Revenue Ruling 89-35 fails to address *Nierotko* as an interpretation of a "wages paid" statutory rule from the same 1939 Act that enacted the tax provisions at issue here. This ruling is little more than a cursory recitation of the statutory language and a reiteration of the Government's unsuccessful arguments before the Sixth Circuit in *Bowman*. See Rev. Rul 89-35, 1989-1 C.B. 280.

Finally, an IRS interpretation of a statute is never afforded deference if it does not harmonize with the statutory, language, origin, structure and purpose. *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979); *Rowan Cos.* v. *United States*, 452 U.S. 247, 252-53 (1981). As noted above, the IRS interpretation fails to distinguish *Nierotko* or address the legislative history and structure of the Social Security Act; results in arbitrary and inconsistent taxation of employees and employers; and creates conflicting rules for purposes of determining benefits and computing taxes, all of which do violence to the basic funding and fairness principles of the Act. *See supra* at 41-45. The IRS's exclusive focus on the words "wages paid" in the FICA tax statute has caused it to disregard the broader structure and purpose of the FICA statute in adopting its interpretation. Such myopia does not illuminate a statute's plain meaning and is not worthy of deference. *National R.R. Passenger Corp. v. Boston & Maine Corp.*, 503 U.S. 407, 417 (1992) ("In ascertaining whether the agency's interpretation is a permissible construction of the language, a court must look to the structure and language of the statute as a whole.").

CONCLUSION

This Court should affirm the judgment below.

Respectfully submitted,

G. MICHAEL HALFENGER
ANNE BERLEMAN KEARNEY
FOLEY & LARDNER
777 E. Wisconsin Avenue
Milwaukee, Wis. 53202
(414) 297-5555

CARTER G. PHILLIPS*
RICHARD D. BERNSTEIN
JOHN F. WESTER
STEPHEN B. KINNAIRD
SIDLEY & AUSTIN
1722 Eye Street, N.W.
Washington, D.C. 20006
(202) 736-8000

Counsel for Respondent

January 16, 2001

* Counsel of Record

(8)

Supreme Court, U.S.
FILED
FEB 16 2001

No. 00-203

In the Supreme Court of the United States

UNITED STATES OF AMERICA, PETITIONER

v.

CLEVELAND INDIANS BASEBALL COMPANY, A LIMITED PARTNERSHIP

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

BARBARA D. UNDERWOOD
Acting Solicitor General
Counsel of Record
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

35 pp

TABLE OF CONTENTS

		Page
I.	Taxes under FICA and FUTA are based on "wages paid during" a calendar year	1
II.	The "should have been paid" rule would reinstitute the difficulties Congress had eliminated by 1946	4
III.	The *Nierotko* allocation rule does not apply in the tax setting	7
IV.	Application of respondent's "should have been paid" rule would have untoward results	15
V.	Treasury regulations and revenue rulings, which allocate back pay to the year of actual payment, are entitled to deference	18
Appendix		1a

TABLE OF AUTHORITIES

Cases:

Atlantic Cleaners & Dyers, Inc. v. *United States*, 286 U.S. 427 (1932)	13
Bartels v. *Birmingham*, 332 U.S. 126 (1947)	20
Biddle v. *C.I.R.*, 302 U.S. 573 (1938)	20
C.I.R. v. *Stidger*, 386 U.S. 287 (1967)	19
Davis v. *United States*, 495 U.S. 472 (1990)	20
Flemming v. *Nestor*, 363 U.S. 603 (1960)	14
Gerbec v. *United States*, 164 F.3d 1015 (6th Cir. 1999)	7
Helvering v. *Stockholms Enskilda Bank*, 293 U.S. 84 (1934)	13
Mazur v. *C.I.R.*, 986 F. Supp. 752 (W.D.N.Y. 1997)	16
National Muffler Dealers Ass'n v. *United States*, 440 U.S. 472 (1979)	19
NationsBank of N.C., N.A. v. *Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995)	13
Nierotko v. *Social Sec. Bd.*, 149 F.2d 273 (6th Cir. 1945), aff'd, 327 U.S. 358 (1946)	9

Cases—Continued: Page

Robinson v. *Sullivan*, 905 F.2d 1199 (8th Cir. 1990) 18
Social Sec. Bd. v. *Nierotko*, 327 U.S. 358 (1946) 7-8, 9, 10, 11, 12
United States v. *Correll*, 389 U.S. 299 (1967) 19, 20

Statutes and regulations:

Federal Insurance Contributions Act, 26 U.S.C. 3101 *et seq.* 1
26 U.S.C. 3101(a) 1
26 U.S.C. 3101(b) 1
26 U.S.C. 3111(a) 1
26 U.S.C. 3111(b) 1
26 U.S.C. 3121(a)(1) 1
26 U.S.C. 3121(a)(4) 16
26 U.S.C. 3121(a)(5)(E) 18
26 U.S.C. 3121(a)(14) 17
26 U.S.C. 3121(i)(5) 18
Federal Unemployment Tax Act, 26 U.S.C. 3301 *et seq.* 1
26 U.S.C. 3301 (1994 & Supp. IV 1998) 1, 7
26 U.S.C. 3302(b) 7
26 U.S.C. 3302(c) 7
26 U.S.C. 3306(b)(1) 1, 7
Revenue Act of 1964, Pub. L. No. 88-272, § 232(a), 78 Stat. 107 4
Social Security Act of 1935, ch. 531, 49 Stat. 620:
Tit. II:
§ 210(a), 49 Stat. 625 ..... 10, 1a
§ 210(c), 49 Stat. 625 ..... 11, 1a
Tit. VIII:
§ 801, 49 Stat. 636 ..... 2, 2a
§ 804, 49 Stat. 637 ..... 2, 3a
§ 811, 49 Stat. 639 ..... 2, 8
Tit. IX:
§ 901, 49 Stat. 639 ..... 3, 4a

Statutes and regulations—Continued: Page

Social Security Amendments of 1939, ch. 666, 53 Stat. 1360:
Tit. II:
§ 209(g), 53 Stat. 1376-1377 ..... 8, 11, 12, 14, 5a
Tit. VI:
§ 601:
53 Stat. 1381 (26 U.S.C. 1400 *et seq.* (1940)) 3, 6a
53 Stat. 1381-1382 ..... 3, 6a
§ 604, 53 Stat. 1383 ..... 3, 7a
§ 607, 53 Stat. 1387 (26 U.S.C. 1432 (1940)) 12
§ 608, 53 Stat. 1387 (26 U.S.C. 1600 *et seq.* (1940)) 3, 8a
§ 614, 53 Stat. 1392-1393 3
§ 615, 53 Stat. 1396 (26 U.S.C. 1611 (1940)) 12
Social Security Act Amendments of 1946, ch. 951, 60 Stat. 978:
§ 412(a), 60 Stat. 989 ..... 3, 9a
§ 412(b), 60 Stat. 989 ..... 3, 9a
Internal Revenue Code, 26 U.S.C. 6501(a) (1994 & IV 1998) 14
42 U.S.C. 405(c)(5)(H) 14
26 C.F.R.:
Pt. 31:
Section 31.3121(a)-(2) 18
Section 31.3121(a)-(2)(a) 1
Section 31.3301-4 18
Pt. 301:
Section 301.7805-1 20

Miscellaneous:

1944-1 C.B. 1 20
1968-1 C.B. 1 20
H.R. Rep. No. 728, 76th Cong., 1st Sess. (1939) 3
H.R. Rep. No. 2447, 79th Cong., 2d Sess. (1946) 3, 4
Mim. 6040, 1946-2 C.B. 155 14-15
Rev. Rul. 89-35, 1989-1 C.B. 280 18

Miscellaneous—Continued: Page

S. Rep. No. 734, 76th Cong., 1st Sess. (1939) 3, 4, 5
S. Rep. No. 1862, 79th Cong., 2d Sess. (1946) 3, 4
Treas. Order No. 111-2, 1981-1 C.B. 698 20

REPLY BRIEF FOR THE UNITED STATES

I. TAXES UNDER FICA AND FUTA ARE BASED ON "WAGES PAID DURING" A CALENDAR YEAR

1. The question presented in this case is whether, for purposes of the Federal Insurance Contributions Act (FICA), 26 U.S.C. 3101 *et seq.*, and the Federal Unemployment Tax Act (FUTA), 26 U.S.C. 3301 *et seq.*, back pay is taxed in the amounts applicable to the year in which it was actually paid or instead to the year or years in which it should have been paid but was not. Five distinct statutory provisions govern that question. Two of them address the rate of FICA tax, and they each provide that that rate is equal to a specified percentage of "wages paid during" a particular year. 26 U.S.C. 3111(a) and (b). Two others define the wage base for FICA social security and FUTA taxes, providing that the term "wages" does not include an amount greater than the wage base for a given year that "is *paid* to [the employee] by [the] employer *during* such calendar year." 26 U.S.C. 3121(a)(1) (emphasis added); 26 U.S.C. 3306(b)(1) (emphasis added). A fifth provision addresses the rate of FUTA tax, and it provides that the rate is "equal to [specified percentages] of the total wages * * * *paid* by [the employer] *during* the calendar year with respect to employment." 26 U.S.C. 3301 (emphasis added).[1]

In all five of those provisions, Congress based the amount of FICA and FUTA taxes on the wages "paid during" a calendar year. It did not base the tax on wages that would or should or could have been paid during a calendar year, had circumstances been other than what they were. Accordingly, wages that are actually paid to a given employee

[1] Two other provisions address the FICA tax levied on employees. See 26 U.S.C. 3101(a)-(b). They are framed in terms of the "wages received" instead of the "wages paid." As respondent agrees (Br. 10 n.8), "[i]n general, wages are received by an employee at the time that they are paid by the employer." 26 C.F.R. 31.3121(a)-2(a). See U.S. Br. 19 n.11.

during a given year are taxed in accordance with the FICA and FUTA provisions applicable to that employee's wages for that year.

2. The history of the FICA and FUTA provisions at issue demonstrates that Congress did not choose the "wages paid" rule in an effort to achieve an abstract ideal of fairness (though Congress's choice is a fair one) or to enhance federal revenues, but with the specific intent to minimize confusion and ease calculation of the taxes for employers, employees, and the IRS.[2] See generally U.S. Br. 13-19, 21-24. Under the original Social Security Act, the amount of tax—not yet labeled "FICA" and "FUTA"—was set based on the year the wages were earned, not the year in which the wages were paid. See § 804, 49 Stat. 637 (social security tax equal to a percentage of "wages * * * paid * * * [w]ith respect to employment during [specified] calendar years"); accord § 801, 49 Stat. 636 (same for "wages * * * received" by employee); § 811, 49 Stat. 639 (social security tax wage base defined to exclude amounts in excess of $3000 paid to an employee in a year "with respect to employment during such calendar year"). Indeed, the unemployment tax provision (the ancestor of the current FUTA provision) was unambiguous on this point, requiring an employer to pay "for each calendar year" a tax on a percentage of wages "payable by him (*regardless of the time of payment*) with respect to employment * * * during such calendar year." § 901, 49 Stat. 639 (emphasis added).[3]

---

[2] Although in this case the "wages * * * paid" rule apparently results in higher taxes, that will not always be the case. For example, a lump-sum back-pay award covering multiple years of employment may exceed the FICA and FUTA wage bases and therefore not be taxed under FICA and FUTA in whole or in part, while allocating that same award over a prior period of years may result in payment of FICA and FUTA taxes on the whole amount. See U.S. Br. 29.

[3] The original unemployment tax did not include a wage base provision. When a wage base provision was added in 1939, however, it was virtually identical to the "with respect to employment during such calendar year" provision defining the social security wage base. See § 614, 53 Stat. 1392-1393.

In 1939, Congress amended the tax rate provisions (in the newly christened FICA and FUTA statutes now moved from Title 42 to to Title 26 of the United States Code, see 26 U.S.C. 1400 *et seq.*, 1600 *et seq.* (1940)) to replace the "with respect to employment in such year" rule with a simpler "wages paid during" a particular year rule. See § 604, 53 Stat. 1383 (FICA tax on employers), § 608, 53 Stat. 1387 (FUTA); see also § 601, 53 Stat. 1381-1382 (FICA tax on employees). In 1946, Congress completed the job by amending the FICA and FUTA wage base definitions to replace the "with respect to employment in such year" provisions with the simpler "wages paid during" a calendar year. See §§ 412(a) (FICA), 412(b) (FUTA), 60 Stat. 989.

The committee reports accompanying the 1939 and 1946 amendments explained the purposes for the changes. The reports emphasized that the original social security tax schemes set the amount of tax based on "the time of the performance of the services for which the wages are paid." H.R. Rep. No. 728, 76th Cong., 1st Sess. 57 (1939) (FICA rate of tax); see also *id.* at 62 (FUTA rate of tax); S. Rep. No. 734, 76th Cong., 1st Sess. 70-71, 75-76 (1939) (same); S. Rep. No. 1862, 79th Cong., 2d Sess. 35-36 (1946) (FICA and FUTA wage base); H.R. Rep. No. 2447, 79th Cong., 2d Sess. 35 (1946). That formula "unnecessarily complicate[d] the making of returns and the collection of the taxes" and resulted in "confusion." H.R. Rep. No. 728, at 57, 58. The 1939 Senate report explained that "[t]he attendant difficulties and confusion cause a burden on employers and administrative authorities alike," while "[t]he placing of this tax on the 'wages paid' basis will relieve this situation." S. Rep. No. 734, at 76. The 1946 Senate report explained that, while formerly taxes had to be paid on remuneration "irrespective of the year of payment," the amendments "constitute as the yardstick the

amount paid during the calendar year * * *, without regard to the year in which the employment occurred." S. Rep. No. 1862, at 35; H.R. Rep. No. 2447, at 35 (same).

3. The "wages paid" rule achieves Congress's purposes. There is very little basis for dispute regarding when wages are "paid" for purposes of FICA or FUTA. The "wages paid" rule is identical to the general rule applicable in calculating income taxes, see U.S. Br. 30, thus easing the confusion for the IRS, employers, and employees that would ensue if a given wage payment were taxable for income tax purposes in one year and for FICA and FUTA purposes in another year.[4] The "wages paid" rule provides a simple, straightforward rule for the routine task of calculating the often relatively small FICA and FUTA taxes.

II. THE "SHOULD HAVE BEEN PAID" RULE WOULD REINSTITUTE THE DIFFICULTIES CONGRESS HAD ELIMINATED BY 1946

1. Respondent argues that wages should be "deemed 'paid' at the time they should have been paid" (Br. 9) under FICA and FUTA. Respondent contends (Br. 26-27) that its "relation-back principle" does not contravene Congress's intent, because it "says nothing about the time when services are performed, or when wages are 'payable'"—the touchstones for FICA and FUTA taxation that Congress expressly repudiated when it amended the relevant statutes in 1939 and 1946.

---

[4] Respondent is correct (Br. 30 n.18) that in 1943 Congress amended the Internal Revenue Code to authorize allocation of back pay to earlier periods for income tax purposes. As respondent notes, that authority was limited to back pay that exceeded 15 % of an employee's income. Moreover, while that provision was a "not * * * greater than" provision that necessarily resulted only in lowering a taxpayer's taxes, the "should have been paid" rule advocated by respondent may equally likely raise the total taxes paid by employees who receive wages at times other than when they "should have been paid." See note 2, *supra*. In any event, Congress eliminated the back pay allocation rule in 1964. § 222(a), 78 Stat. 107.

2. Respondent's "should have been paid" rule, however, would reinstate the "difficulties and confusion" that Congress remedied through the 1939 and 1946 amendments—and worse. The time when wages "should have been paid" is precisely the time when wages are "payable"—the standard under the original unemployment tax provisions of the Social Security Act that Congress replaced with the current "wages paid" rule. See p. 2, *supra*. Moreover, in most ordinary employment situations, the employer pays the employee for services performed during a particular period of time. Therefore, to determine when wages "should have been paid," it is ordinarily necessary, first, to determine the date of the services for which the wages are to be paid, and, second, to determine the date on which wages for those services should be paid. Only after going through both steps can respondent's rule—based on when, "in the ordinary course," Resp. Br. 36, 38, wages "should have been paid"—be applied.

The first of these inquiries—determining the date when the services were (or should have been) performed—requires the employer, employee, and the IRS to determine the period of employment with respect to which wages were paid before the tax rates and wage base can be determined. That is precisely the inquiry that Congress rejected when it amended FICA and FUTA in 1939 and 1946.

After identifying the time period when the employee's services were provided, the next step is to identify when the wages for that time period would have been paid "in the ordinary course." Resp. Br. 36, 38. There is little precedent for such a determination, because even the pre-1939 and pre-1946 statutes did not require that additional step. Employment relationships in our society vary widely, especially for seasonal, casual, or part-time workers, or (as the committee report on the 1939 amendments noted) employees compensated through bonuses or "a percentage of profits, or * * * future royalties." S. Rep. No. 734, at 75. It can therefore be

predicted that determining the date when wages should have been paid will be a fruitful source of conflict and litigation. In our self-reporting system, respondent's rule also offers an avenue for employers and employees to attempt to claim whatever application of the "should have been paid" rule will benefit them in a given case.[5]

3. In the back pay context, the "should have been paid" rule could generate disputes and uncertainty even in litigated or arbitrated cases, since a trier of fact or arbitrator often need not settle disputes concerning the precise period of employment for which back pay is awarded or the date on which back pay would have been paid "in the ordinary course." Resp. Br. 36, 38. In cases that are resolved by settlement, the parties would have an incentive to characterize the period covered by a back pay award in accordance with their own interests in minimizing taxes, rather than addressing when the back pay genuinely "should have been paid."

The confusion engendered by the "should have been paid" rule would not be limited to the increasingly common back-pay context. Respondent steadfastly rejects (Br. 44 n.23) any limitation of the "should have been paid" rule to *statutory*—as opposed to tort-based or contractual—back-pay claims. Moreover, if the time when wages are "paid" depends on when they "should have been paid" in back pay cases, the time when wages are "paid" should logically depend on when they "should have been paid" in other situations as well. Respondent's arguments therefore would pre-

[5] There is no reason why employer and employee would necessarily agree on the time when particular wages "should have been paid." In a given case an employee may have an interest in allocating FICA employee taxes to one year (when, for example, the employee has paid the maximum FICA social security taxes by reason of having several employers), while the employer would prefer to allocate the payments to another year (when, perhaps, other affected employees are likely to have exceeded the FICA and FUTA ceilings). Under respondent's rule, the IRS would have to reconcile the conflicting positions.

sumably apply whenever an employee is not paid on the date when, "in the ordinary course," Br. 36, 38, the employee would have been paid. That would encompass "front pay" claims, in which an employee seeks a money recovery for *future* work not performed. See, *e.g.*, *Gerbec* v. *United States*, 164 F.3d 1015, 1020-1023 (6th Cir. 1999) (noting circuit conflict in characterizing front pay settlement proceeds). It would also encompass any other case in which, for any reason or no reason, an employer pays wages on a date that is not (or is asserted not to be) the date on which the wages "should have been paid." An employer who decides to pay a bonus that has no set "ordinary course" date, or to make a partial payment to a commissioned salesperson pending a year-end calculation of commission due, would have to determine when the wages "should have been paid" before determining the amount of tax due. In all such cases, respondent's rule would breed disputes and litigation.

4. It made eminent sense for Congress to adopt the easily administrable "wages paid" rule in the context of the FICA and FUTA statutes. FICA and FUTA taxes are ordinarily relatively modest, on a per-employee basis; FUTA taxes, for example, are ordinarily limited to $56 per employee per year. See 26 U.S.C. 3301 (6.2% FUTA basic tax rate), 3302(b)-(c) (5.4% credit for employers who make timely contributions to state unemployment fund), 3306(b)(1) ($7000 wage base). Congress therefore embraced the values of certainty and stability offered by the "wages paid" rule and eschewed the high transaction costs and uncertainty of the rule originally embodied in the FICA and FUTA. It follows *a fortiori* that Congress eschewed the even more complex "should have been paid" rule that respondent espouses.

III. THE *NIEROTKO* ALLOCATION RULE DOES NOT APPLY IN THE TAX SETTING

Respondent argues (Br. 16) that the question presented in this case was decided by this Court in *Social Sec. Bd.* v.

Nierotko, 327 U.S. 358 (1946). The Court in *Nierotko*, however, saw the question before it as having to do solely with benefits, did not address or discuss the provisions of the FICA and FUTA tax statutes at issue here, and even as to the benefits issue applied an earlier version of the statute that has now been superseded. *Nierotko* accordingly provides no support for respondent's rule.

1. The primary question at issue in *Nierotko*—indeed, the only question presented in the petition for certiorari—was whether back pay is "wages" for purposes of determining an employee's entitlement to social security benefits. The Court held that back pay does constitute "wages" for that purpose, relying primarily on the fact that the statutory definition of "employment" as "any service . . . performed . . . by an employee for his employer" is one that "import[s] breadth of coverage" and "means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." 327 U.S. at 365-366 (quoting § 811, 49 Stat. 639).

After an extensive discussion of that issue, the Court turned in the final two paragraphs of its opinion to one final argument that had been advanced by the government. The Court explained that "petitioner argues," 327 U.S. at 370, that the Act's requirement that wages must be allocated to particular quarters for purposes of determining eligibility under Section 209(g) of the 1939 Amendments

> tends to show that 'back pay' cannot be wages because the Amendments of 1939 use 'quarters' as the basis for eligibility as well as the measure of benefits and require 'wages' to be 'paid' in certain 'quarters.'
>
> If, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods when the regular wages were not paid as usual. Admittedly there are accounting difficulties which the Board will be called upon to solve but we do not believe they are insuperable.

Ibid. (footnote omitted). Respondent argues that the same allocation rule should be applied to the FICA and FUTA tax provisions.

2. Respondent's contention is mistaken.

a. Initially, the *Nierotko* case presented the question whether the claimant in that case was eligible for social security benefits; the case had nothing to do with taxes. The passage quoted above refers only to "eligibility" and the "measure of benefits", not to any tax issue. See also 327 U.S. at 361 (explaining that "[w]ages are the basis for the administration of federal old age *benefits*" and time periods "may be crucial on *eligibility* under either the original act or the Amendments of 1939") (emphasis added). The court of appeals had decided the case in the claimant's favor based largely "upon consideration of the great humanitarian purpose of the Social Security Act in all of its aspects." *Nierotko* v. *Social Sec. Bd.*, 149 F.2d 273, 274 (6th Cir. 1945). This Court similarly decided the case on the ground that, "with the purpose of the Social Security Act in mind," the Act's terms "import breadth of coverage." 327 U.S. at 365. As our opening brief explains (at 28-29), that rationale has nothing whatever to do with the considerations of administrative ease and dispute avoidance that motivated Congress to amend the FICA and FUTA tax provisions. Accordingly, it ought not govern interpretation of those tax provisions.

Indeed, while the Court's opinion in *Nierotko* cited and quoted extensively from benefits provisions of the Social Security Act, it did not discuss or quote any tax provision. The closest the Court came was to quote the Act's definition of "wages" in Section 210(a)—a provision applicable both to the tax and benefits provisions of the 1935 Act. See 327 U.S.

at 362.[6] And even there, the Court omitted from its quotation of the Section 210(a) definition of "wages" the portion that included the "with respect to employment during such calendar year" language defining the wage base that was of special importance for tax purposes under the original Act.

The Court in *Nierotko* obviously believed that it could decide the benefits questions before it without regard to the tax provisions at issue here. Cf. Resp. Br. 20 ("[T]he wage ceiling was not at issue in *Nierotko*."). Having analyzed the benefits issue in *Nierotko* without consideration of the language and history of the tax provisions, this Court ought not now assume, as respondent suggests, that the *Nierotko* holding must after all be extended to apply to taxes as well. To do so would frustrate Congress's expressed intent, embodied in the 1939 and 1946 amendments and reiterated in their legislative history, that an easy-to-administer "wages paid" rule applies to tax liabilities under FICA and FUTA.

b. Respondent argues that this Court in *Nierotko* decided the allocation issue under the 1939 Amendments, not the original version of the Act enacted in 1935. See Resp. Br. 6-7, 11, 18-19, 20-21. We continue to believe that respondent is wrong on that point. See U.S. Br. 27 n.14. But even if correct, respondent's claim would have no impact on the issues here.

With respect to whether the 1939 Amendments or the 1935 Act governed the allocation issue in *Nierotko*, the Court stated in the passage quoted above, see p. 9, *supra*, that "petitioner [the government] argues"—not that the Court accepts—that the need to allocate wages to certain quarters for purposes of benefits calculations under the 1939 Amendments supports the conclusion that back pay is not wages.

---

[6] Because the term "wages" was defined in a single provision for purposes of both taxes and benefits under the 1935 Act, the Court did briefly mention some tax regulations and an Office Decision of the Bureau of Internal Revenue with respect to the question whether back pay is to be viewed as "wages." 327 U.S. at 366 n.17, 367.

327 U.S. at 370.[7] The Court had earlier in the opinion made clear that the major question before it—the question whether back pay is wages for benefits eligibility purposes—was governed by the original 1935 Act. See *id.* at 360 ("the governing provisions which determine whether this 'back pay' is wages are those of the earlier enactment"). Having relied on the 1935 Act to resolve the basic question of whether back pay is wages, the Court had no reason to rely on a different version of the statute to decide the allocation question.

Moreover, in the passage regarding allocation quoted above, the Court did not expressly or impliedly depart from the conclusion that the 1935 Act governed. The single sentence that states the Court's view—rather than the government's argument—recites that "[i]f, as we have held above, 'back pay' is to be treated as wages, we have no doubt that it should be allocated to the periods when the regular wages were not paid as usual." 327 U.S. at 370. That sentence does not address any question regarding which version of the Act was controlling. However, by referring broadly to "periods" (which includes the timing rules for benefits under the 1935 Act, see § 210(c), 49 Stat. 625 (defining "qualified individual")) rather than to "quarter[s]" (relevant for the timing rules for benefits under the 1939 Act, see § 209(g), 53 Stat. 1376-1377 (defining "fully insured individual")), the statement suggests that the 1935 Act provisions controlled the timing of the benefit calculation.[8]

---

[7] Both parties in *Nierotko* briefed the case entirely as if the 1939 Amendments controlled the case. Neither party addressed the issue of which version of the Act governed either the primary question whether back pay is wages or the secondary question concerning the allocation of wages to prior periods for benefits purposes.

[8] Had the Court considered the tax provisions of the 1935 Act, it would have found that those provisions supported its conclusion on the allocation issue. See U.S. Br. 26-27. As explained above, see pp. 2-3, *supra*, those provisions tied social security and unemployment taxes to wages paid (or, in the case of FUTA, "payable") "with respect to employ-

Even if the Court in *Nierotko* had viewed the 1939 Amendments as governing the allocation of back pay to particular time periods for benefits purposes, the Court at most considered the 1939 amendments to the *benefits* scheme in the Social Security Act, which remained after 1939 in Title 42 of the United States Code. There is no reason to believe that, in considering the benefit allocation issue, the Court considered the tax statutes (the now newly entitled FICA and FUTA, see 26 U.S.C. 1432, 1611 (1940)), that had been re-enacted and moved to Title 26. The only statutory provision cited in this part of the Court's discussion was the new 1939 definition of "fully insured individual" in Section 209(g)—a provision applicable only to benefits. See 327 U.S. at 370 n.25. Moreover, the only provisions of the 1939 amendments cited or quoted elsewhere in the Court's opinion were that and other benefits provisions, whose enactment had nothing to do with ending the "difficulties" and "confusion" caused by the earlier tax provisions. See, *e.g.*, *id.* at 360 & nn.2 & 5, 361-362 & n.7, 363 n.10, 364 n.13. Nothing in *Nierotko* suggests that the Court was taking into account the 1939 amendments to FICA and FUTA.

Finally, even if the Court in *Nierotko* had considered the 1939 amendments to FICA and FUTA, *Nierotko* would still have no bearing on the analysis in this case. Congress did not finally place the FICA and FUTA taxes on a "wages paid" basis until the 1946 amendments were enacted—after this Court's decision in *Nierotko*. Between 1939 and 1946, the tax rate provisions in FICA and FUTA were phrased in terms of "wages paid during" a given year, but the wage base definitions in both statutes were still phrased in terms

---

ment during [a particular] calendar year." Moreover, the definition of the wage base as sums paid "with respect to employment during [a particular] calendar year" was identical in the tax and benefits provisions of the 1935 Act. See U.S. Br. 26 n.13. It was only in 1946 that Congress modified the definition of "wages"—which included the definition of the wage base—to include a "wages paid" rule.

of remuneration "paid * * * with respect to employment during" a given year. It is the post-1946 provisions of FICA and FUTA—not the benefits provisions of the Social Security Act or even the pre-1946 versions of FICA and FUTA—that govern this case.

3. Respondent's argument thus reduces to the contention (Br. 23-26) that the benefits provisions of the Social Security Act in Title 42 and the FICA and FUTA tax statutes in Title 26 both use "wages paid" formulations, and that the *Nierotko* rule must therefore be applied to both. This Court has long recognized that the "presumption that identical words used in different parts of the same act are intended to have the same meaning * * * is not rigid." *Atlantic Cleaners & Dyers, Inc.* v. *United States*, 286 U.S. 427, 433 (1932); accord *NationsBank of N.C., N.A.* v. *Variable Annuity Life Ins. Co.*, 513 U.S. 251, 262 (1995); *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934). As the Court stated in *Atlantic Cleaners & Dyers*, 286 U.S. at 433:

> Where the subject-matter to which the words refer is not the same in the several places where they are used, or the conditions are different, or the scope of the legislative power exercised in one case is broader than that exercised in another, the meaning well may vary to meet the purposes of the law, to be arrived at by a consideration of the language in which those purposes are expressed, and of the circumstances under which the language was employed.

The Court in *Nierotko* construed the benefits provisions of the Social Security Act on the basis of considerations that have no application to the FICA and FUTA tax provisions as they were amended by Congress in 1939 (and again, subsequently, in 1946), and the Court viewed as irrelevant the FICA and FUTA provisions that govern this case. Accordingly, *Nierotko* poses no obstacle to effectuating Congress's intent in amending the tax provisions.

A difference between the rule applicable in calculating FICA and FUTA taxes and the rule applicable in calculation of social security benefits would not be unusual. See U.S. Br. 28-29. There are other circumstances in which wages may be allocated to different periods for purposes of taxes and benefits. That can occur when, for example, an individual obtains modification of his earnings record for benefits purposes for a long past time period, see 42 U.S.C. 405(c)(5)(H), even though the amount of tax for that period cannot be altered because of the generally applicable three-year statute of limitations, see 26 U.S.C. 6501(a). Respondent is correct (Br. 24) that Congress intended "to preserve the essential character of Social Security as a solvent 'contributory' system of social insurance." But the contributions of any given individual have never had a close relationship to the benefits that individual would receive. See *Flemming* v. *Nestor*, 363 U.S. 603, 609 (1960). Congress's intent that individuals receive benefits only if they also make contributions, as well as its desire to maintain the solvency of the system as a whole, is not implicated or affected by the question presented in this case.

4. Respondent argues (Br. 20-22) that Congress should be assumed to have embodied the *Nierotko* rule in the amendments that it enacted in 1946, six months after *Nierotko* was decided. There is no evidence that Congress considered *Nierotko* when it enacted the 1946 amendments. At most, however, the 1946 Congress would have assumed that the *Nierotko* rule provided an interpretation of the benefits provisions of the Social Security Act—Section 209(g), in particular. As noted above, *Nierotko* did not purport to resolve any tax issue and Congress would have had no reason to believe that it did. In addition, as respondent concedes (Br. 26), shortly after *Nierotko* was decided, the Internal Revenue Service issued Mim. 6040, 1946-2 C.B. 155, in which it advised employers that, although *Nierotko* requires that "back pay awards * * * in compliance with an

order of the [NLRB] constitute 'wages,' * * * as defined in the Federal employment tax statutes," *id.* at 155-156, an employer should include the "'back pay' *paid* by him *during* the quarter" in preparing employment tax returns, *id.* at 156 (emphasis added). Accordingly, Congress would likely have relied on the Treasury's consistent position on that point, see U.S. Br. 19-20 & n.10, when adding the "wages paid" language to the FICA and FUTA wage base provisions in 1946. Indeed, the committee reports on the 1946 legislation and the Treasury regulations are entirely in accord.

IV. APPLICATION OF RESPONDENT'S "SHOULD HAVE BEEN PAID" RULE WOULD HAVE UNTOWARD RESULTS

Respondent's replacement of the statutory "wages paid" rule with an indeterminate "should have been paid" rule would interfere with sound administration of the FICA and FUTA tax schemes.

1. Respondent errs in arguing (Br. 43-44) that under its "should have been paid" rule, "an employer never has an incentive to create or prolong a wage dispute." Employers generally have the usual incentive to prolong a wage dispute —to keep possession of the money that would have been paid at an earlier date. But, because the FICA social security wage base tends to increase over time with inflation, under the "wages paid" rule employers have a modest built-in incentive not to delay their payment of wages. In any event, the FICA and FUTA systems are based on the premise that other factors and employment regulations—not the relatively modest amount of FICA and FUTA taxes—will determine when wages are paid. Under the "wages paid" rule in FICA and FUTA, whenever wages are paid, the taxes must be paid as well.[9]

---

[9] Contrary to the suggestion of amicus Major League Baseball Players Association (Br. 7-8), the "wages paid" rule should not result in any detriment to employees due to an employer's failure to pay wages when

2. Respondent cites (Br. 32-33) the exclusion from "wages" of "any payment on account of sickness or accidental disability * * * made" to an employee more than six months after the employee last worked for the employer. 26 U.S.C. 3121(a)(4). Respondent argues that back pay should be subject to FICA tax under that provision if it in fact was paid more than six months after the employee ceased work but should have been paid earlier, within the six-month period. The six-month rule in Section 3121(a)(4), however, like most rules setting fixed time periods, enhances certainty and simplifies calculations for the employer, employee, and the IRS, by clearly delineating which payments may be excluded from the FICA and FUTA wage base and which may not. Under respondent's rule, all parties concerned would have to determine, for each payment made more than six months after employment ended, whether it "should have been paid" at some earlier date and therefore must be included in the wage base. Indeed, respondent's rule would also presumably require all parties involved to determine, for each payment made *within* the six-month period, whether it "should have been paid" at a later date and therefore should be excluded from the wage base. The resulting administrative difficulties and confusion are just what Congress sought to avoid in drafting the provisions at issue.

3. The same is true of respondent's reference (Br. 34) to the exclusion from FICA wages of "any payment made by an employer to the survivor or the estate of a former employee after the calendar year in which such employee died." 26 U.S.C. 3121(a)(14). Respondent's "should have been paid" rule would replace an easily administrable statutory exception with a rule that would require that the IRS examine every such payment after the calendar year of death to determine whether it "should have been paid" earlier, and every payment within the calendar year of death or earlier to determine whether it "should have been paid" later. Respondent expresses concern (Br. 34) that, "[w]ithout the relation-back principle of *Nierotko*, surviving widows and children * * *, could lose benefits altogether." What is at issue here, however, is taxes, not benefits. Under respondent's "should have been paid" rule, needy surviving widows and children who receive back pay would be forced to pay a FICA tax that Congress determined in Section 3121(a)(14) was unnecessary.

4. The same problems infect respondent's argument (Br. 35-39) that its "should have been paid" rule should apply to long-since repealed FICA and FUTA provisions that made student and some other employment taxable in part on the basis of a timing-of-payment rule, and to current FUTA provisions that use a timing-of-payment rule in part to define "employer." Because FUTA taxes are ordinarily quite small in amount, see p. 7, *supra*, transaction costs would make it impractical to applying respondent's rule to FUTA taxes. And in general, respondent's citation to these provisions merely demonstrates that the "should have been paid" rule has no logical stopping place. In each case, settled and certain methods for calculating taxes due would be replaced with uncertain determinations of the period of employment compensated by particular wages and when those wages "should have been paid." That is not what Congress intended when it drafted the precisely worded definitions and exceptions in the FICA and FUTA statutes.[10]

---

due. If calculating the employee's FICA taxes in the year the wages were actually paid would result in under-compensation of the employee, the employee should include that amount in the "make-whole" damages sought from the employer. See *Mazur* v. *C.I.R.*, 986 F. Supp. 752, 756 (W.D.N.Y. 1997) ("[T]he remedy * * * is obtained against the wrongdoer and not against the United States or its Treasury.").

[10] Respondent also refers (Br. 33) to the FICA provision exempting payments to retired federal judges serving on active duty if the payment "is received during the period of such service." 26 U.S.C. 3121(i)(5). Respondent claims (Br. 33) that under the "wages paid" rule, "a retired federal judge or justice who receives a back pay award covering active-

V. TREASURY REGULATIONS AND REVENUE RULINGS, WHICH ALLOCATE BACK PAY TO THE YEAR OF ACTUAL PAYMENT, ARE ENTITLED TO DEFERENCE

Even prior to the Court's decision in *Nierotko* and continuing to the present day, the Treasury Regulations adopted an actual payment rule. See U.S. Br. 19-20 & n.10. Respondent concedes that the regulations applicable to the time period here at issue have not been substantively changed. Resp. Br. 48; see also U.S. Br. 19-20, 24-25. Respondent nonetheless argues (Br. 48-50) that the regulations should not control.

1. Respondent's contention (Br. 48) that the regulations do not specifically discuss back pay is mistaken. The regulations state a general rule of *actual* payment, 26 C.F.R. 31.3121(a)-2, 31.3301-4; see also J.A. 38-42 (gathering other related regulations), and they do not create an exception for back pay. See U.S. Br. 19-20. Moreover, the Treasury has issued Revenue Ruling 89-35, 1989-1 C.B. 280, specifically applying the actual payment rule in the context of back pay, thereby foreclosing the argument that the rule in the regulations does not apply to back pay. See also U.S. Br. 20 (citing other Revenue Rulings). Notwithstanding numerous amendments to the FICA scheme since 1946, Congress has

---

duty service after service is complete must pay the full amount of FICA tax," which would allegedly be "contrary to the clear congressional intent." Payments to retired judges not on active duty, however, are likely to be exempted from FICA tax in any event, either because they are not remuneration for employment under the particular scheme governing such payments or because they are made under an "exempt governmental deferred compensation plan." 26 U.S.C. 3121(a)(5)(E). See *Robinson* v. *Sullivan*, 905 F.2d 1199 (8th Cir. 1990) (senior judges exempted from FICA, regardless of whether they perform judicial services). If it were otherwise, then even under respondent's theory senior judges would be subject to FICA taxes on payments for active service if such payments are received when they "should have been" but after the active service is complete.

never indicated any disagreement with the plain reading of the statutory provisions by the Treasury and the IRS.

2. For the reasons discussed in detail in the briefs recently filed by the United States in *United States* v. *The Mead Corp.*, No. 99-1434 (argued Nov. 8, 2000), respondent errs in asserting (Br. 48) that Treasury rulings and regulations "[are] not entitled to deference." See 99-1434 U.S. Br. at 23-27; 99-1434 U.S. Reply Br. at 1-5 & n.3. (We have provided copies of those briefs to respondent's consel.). This Court has consistently held that the authoritative interpretive rulings and regulations adopted by the Treasury to implement the Internal Revenue Code must be upheld when they represent a "reasonable" interpretation of the statute. *United States* v. *Correll*, 389 U.S. 299, 307 (1967). The Court has explained that the agency's interpretative rulings are to be upheld when "reasonable" because "Congress has delegated to the Commissioner, not to the courts, the task of prescribing 'all needful rules and regulations for the enforcement' of the Internal Revenue Code. 26 U.S.C. § 7805(a)." *Ibid.* The Court has emphasized that "we do not sit as a committee of revision to perfect the administration of the tax laws," and that, "[i]n this area of limitless factual variations, 'it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments.'" *Ibid.* (quoting *C.I.R.* v. *Stidger*, 386 U.S. 287, 296 (1967)). Affording such deference to the Treasury's interpretations of the Code "helps guarantee that the rules will be written by 'masters of the subject,' *United States* v. *Moore*, 95 U.S. 760, 763 (1878), who will be responsible for putting the rules into effect." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979).

Before the 1960's, the Secretary had not made a formal, general delegation of rulemaking authority to the Commissioner. Because the rulings adopted by the Commissioner prior to that date were not binding on the Department or on the Secretary, they did not have the same status as the

Treasury Regulations and Treasury Decisions that *were* adopted directly by the Secretary. See *Bartels* v. *Birmingham*, 332 U.S. 126, 132 (1947) (citing 1944-1 C.B. 1). Prior to 1960, the Court had therefore concluded that the "departmental rulings *not* promulgated by" the Secretary were to be given little deference. *Biddle* v. *C.I.R.*, 302 U.S. 573, 582 (1938) (emphasis added). In 1961, however, the Secretary of the Treasury made a formal, general delegation of rulemaking authority to the Commissioner, subject only to the requirement that the rulings and regulations adopted by the Commissioner be issued with the "approval of the Secretary." 26 C.F.R. 301.7805-1. See also Treas. Order No. 111-2, 1981-1 C.B. 698, 699 (delegating authority "to make the final determination" on "regulations" and "Revenue Rulings" to the Assistant Secretary of the Treasury (Tax Policy)). Under this modern scheme of administration, although the Revenue Rulings adopted by the Commissioner and approved by the Secretary are inherently narrower in their scope—and thus have a narrower "force and effect"—than broadly applicable "regulations," see *Davis* v. *United States*, 495 U.S. 472, 484 (1990), "they [now] may be used as precedents" (1968-1 C.B. 1) and are therefore to be sustained if they establish a "reasonable" interpretation of the statute. *Correll*, 389 U.S. at 307. "The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner." *Ibid.*

* * * * *

For the reasons stated above and in our opening brief, the decision of the court of appeals should be reversed.

Respectfully submitted.

BARBARA D. UNDERWOOD
Acting Solicitor General

FEBRUARY 2001

APPENDIX

STATUTORY PROVISION

1. Section 202(a) of the Social Security Act of 1935, ch. 531, Tit. II, 49 Stat. 623 (42 U.S.C. 402(a) (Supp. II 1937)), provides in pertinent part:

> Every qualified individual (as defined in section 210) shall be entitled to receive * * * an old-age benefit (payable as nearly as practicable in equal monthly installments) * * *.

2. Section 210(a) of the Social Security Act of 1935, ch. 531, Tit. II, 49 Stat. 625 (42 U.S.C. 410(a) (Supp. II 1937)), provides:

> The term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include that part of the remuneration which, after remuneration equal to $3,000 has been paid to an individual by an employer with respect to employment during any calendar year, is paid to such individual by such employer with respect to employment during such calendar year.

3. Section 210(c) of the Social Security Act of 1935, ch. 531, Tit. II, 49 Stat. 625 (42 U.S.C. 410(c) (Supp. II 1937)), provides:

> The term "qualified individual" means any individual with respect to whom it appears to the satisfaction of the Board that—
>
> (1) He is at least sixty-five years of age; and
>
> (2) The total amount of wages paid to him, with respect to employment after December 31, 1936, and before

he attained the age of sixty-five, was not less than $2,000 * * *.

4. Section 801 of the Social Security Act of 1935, ch. 531, Tit. VIII, 49 Stat. 636 (42 U.S.C. 1001 (Supp. II 1937)), provides:

Income tax on employees. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

(2) With respect to employment during the calendar years 1940, 1941, and 1942, the rate shall be 1 1/2 per centum.

(3) With respect to employment during the calendar years 1943, 1944, and 1945, the rate shall be 2 per centum.

(4) With respect to employment during the calendar years 1946, 1947, and 1948, the rate shall be 2 1/2 per centum.

(5) With respect to employment after December 31, 1948, the rate shall be 3 per centum.

5. Section 804 of the Social Security Act of 1935, ch. 531, Tit. VIII, 49 Stat. 637 (42 U.S.C. 1004 (Supp. II 1937)), provides:

Excise tax on employers. In addition to other taxes, every employer shall pay an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 811) paid by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

(2) With respect to employment during the calendar years 1940, 1941, and 1942, the rate shall be 1 1/2 per centum.

(3) With respect to employment during the calendar years 1943, 1944, and 1945, the rate shall be 2 per centum.

(4) With respect to employment during the calendar years 1946, 1947, and 1948, the rate shall be 2 1/2 per centum.

(5) With respect to employment after December 31, 1948, the rate shall be 3 per centum.

6. Section 811(a) of the Social Security Act of 1935, ch. 531, Tit. VIII, 49 Stat. 639 (42 U.S.C. 1011(a) (Supp. II 1937)), provides:

The term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include that part of the remuneration which, after

remuneration equal to $3,000 has been paid to an individual by an employer with respect to employment during any calendar year, is paid to such individual by such employer with respect to employment during such calendar year.

7. Section 901 of the Social Security Act of 1935, ch. 531, Tit. IX, 49 Stat. 639 (42 U.S.C. 1101 (Supp. II 1937)), provides:

> **Imposition of tax.** On and after January 1, 1936, every employer (as defined in section 907) shall pay for each calendar year an excise tax, with respect to having individuals in his employ, equal to the following percentages of the total wages (as defined in section 907) payable by him (regardless of the time of payment) with respect to employment (as defined in section 907) during such calendar year:
>
> (1) With respect to employment during the calendar year 1936 the rate shall be 1 per centum;
>
> (2) With respect to employment during the calendar year 1937 the rate shall be 2 per centum;
>
> (3) With respect to employment after December 31, 1937, the rate shall be 3 per centum.

8. Section 202(a) of the Social Security Act Amendments of 1939, ch. 666, Tit. II, 53 Stat. 1363-1364 (42 U.S.C. 402(a) (1940)), provides:

> Every individual, who (1) is a fully insured individual (as defined in section 209(g)) after December 31, 1939, (2) has attained the age of sixty-five, and (3) has filed application for primary insurance benefits, shall be entitled to receive a primary insurance benefit (as defined in section 209(e)) for each month, beginning with the month in

> which such individual becomes so entitled to such insurance benefits and ending with the month preceding the month in which he dies.

9. Section 209(a)(1) and (2) of the Social Security Act Amendments of 1939, ch. 666, Tit. II, 53 Stat. 1373 (42 U.S.C. 409(a)(1) and (2) (1940)), provides:

> The term 'wages' means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include—
>
> (1) That part of the remuneration which, after remuneration equal to $3,000 has been paid to an individual by an employer with respect to employment during any calendar year prior to 1940, is paid to such individual by such employer with respect to employment during such calendar year; [or]
>
> (2) That part of the remuneration which, after remuneration equal to $3,000 has been paid to an individual with respect to employment during any calendar year after 1939, is paid to such individual with respect to employment during such calendar year[.]

10. Section 209(g) of the Social Security Act Amendments of 1939, ch. 666, Tit. II, 53 Stat. 1376-1377 (42 U.S.C. 409(g) (1940)), provides:

> (g) The term 'fully insured individual' means any individual with respect to whom it appears to the satisfaction of the Board that—
>
> (1) He had not less than one quarter of coverage for each two of the quarters elapsing after 1936, or after the quarter in which he attained the age of twenty-one, whichever quarter is later, and up to but excluding the

quarter in which he attained the age of sixty-five, or died, whichever first occurred, and in no case less than six quarters of coverage; or

(2) He had at least forty quarters of coverage.

As used in this subsection * * *, the term 'quarter' and the term 'calendar quarter' mean a period of three calendar months ending on March 31, June 30, September 30, or December 31; and the term 'quarter of coverage' means a calendar quarter in which the individual has been paid not less than $50 in wages. * * *

11. Section 601 of the Social Security Act Amendments of 1939, ch. 666, Tit. VI, 53 Stat. 1381-1382 (26 U.S.C. 1400 (1940)), provides:

Rate of Tax. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 1426(a)) received by him after December 31, 1936, with respect to employment (as defined in section 1426(b)) after such date:

(1) With respect to wages received during the calendar years 1939, 1940, 1941, and 1942, the rate shall be 1 per centum.

(2) With respect to wages received during the calendar years 1943, 1944, and 1945, the rate shall be 2 per centum.

(3) With respect to wages received during the calendar years 1946, 1947, and 1948, the rate shall be 2 1/2 per centum.

(4) With respect to wages received after December 31, 1948, the rate shall be 3 per centum.

12. Section 604 of the Social Security Act Amendments of 1939, ch. 666, Tit. VI, 53 Stat. 1383 (26 U.S.C. 1410 (1940)), provides:

Rate of Tax. In addition to other taxes, every employer shall pay an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 1426(a)) paid by him after December 31, 1936, with respect to employment (as defined in section 1426(b)) after such date:

(1) With respect to wages paid during the calendar years 1939, 1940, 1941, and 1942, the rate shall be 1 per centum.

(2) With respect to wages paid during the calendar years 1943, 1944, and 1945, the rate shall be 2 per centum.

(3) With respect to wages paid during the calendar years 1946, 1947, and 1948, the rate shall be 2 1/2 per centum.

(4) With respect to wages paid after December 31, 1948, the rate shall be 3 per centum.

13. Section 606(a) of the Social Security Act Amendments of 1939, ch. 666, Tit. VI, 53 Stat. 1383 (26 U.S.C. 1426(a) (1940)), provides in pertinent part:

Wages.—The term 'wages' means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include—

(1) That part of the remuneration which, after remuneration equal to $3,000 has been paid to an individual by an employer with respect to employment during any cal-

endar year, is paid to such individual by such employer with respect to employment during such calendar year[.]

14. Section 608 of the Social Security Act Amendments of 1939, ch. 666, Tit. VI, 53 Stat. 1387 (26 U.S.C. 1600 (1940)), provides:

> **Rate of tax.** Every employer (as defined in section 1607(a)) shall pay for the calendar year 1939 and for each calendar year thereafter an excise tax, with respect to having individuals in his employ, equal to 3 per centum of the total wages (as defined in section 1607(b)) paid by him during the calendar year with respect to employment (as defined in section 1607(c)) after December 31, 1938.

15. Section 614(b) of the Social Security Act Amendments of 1939, ch. 666, Tit. VI, 53 Stat. 1392-1393 (26 U.S.C. 1607(b) (1940)), provides in pertinent part:

> **Wages.**—The term 'wages' means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include—
>
> (1) That part of the remuneration which, after remuneration equal to $3,000 has been paid to an individual by an employer with respect to employment during any calendar year, is paid to such individual by such employer with respect to employment during such calendar year[.]

16. Section 412(a) of the Social Security Act Amendments of 1946, ch. 951, Tit. IV, 60 Stat. 989 (26 U.S.C. 1426(a) (1946)), provides in pertinent part:

> **Wages.**
>
> The term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include—
>
> (1) That part of the remuneration which, after remuneration equal to $3,000 has been paid to an individual by an employer with respect to employment during any calendar year is paid, prior to January 1, 1947, to such individual by such employer with respect to employment during such calendar year; or that part of the remuneration which, after remuneration equal to $3,000 with respect to employment after 1936 has been paid to an individual by an employer during any calendar year after 1946, is paid to such individual by such employer during such calendar year[.]

17. Section 412(b) of the Social Security Act Amendments of 1946, ch. 951, Tit. IV, 60 Stat. 989 (26 U.S.C. 1607(b) (1946)), provides:

> **Wages.**
>
> The term "wages" means all remuneration for employment, including the cash value of all remuneration paid in any medium other than cash; except that such term shall not include —
>
> (1) That part of the remuneration which, after remuneration equal to $3,000 has been paid to an individual by an employer with respect to employment during any

calendar year, is paid after December 31, 1939, and prior to January 1, 1947, to such individual by such employer with respect to employment during such calendar year; or that part of the remuneration which, after remuneration equal to $3,000 with respect to employment after 1938 has been paid to an individual by an employer during any calendar year after 1946, is paid to such individual by such employer during such calendar year[.]

JAN 16 2001

No. 00-203

Supreme Court, U.S.
FILED
JAN 16 2001
CLERK

IN THE

Supreme Court of the United States

UNITED STATES OF AMERICA,
Petitioner,

v.

CLEVELAND INDIANS BASEBALL COMPANY,
A LIMITED PARTNERSHIP,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF *AMICUS CURIAE* OF THE MAJOR LEAGUE BASEBALL PLAYERS ASSOCIATION IN SUPPORT OF RESPONDENT

DONALD M. FEHR
Executive Director and General Counsel
MAJOR LEAGUE BASEBALL PLAYERS ASSOCIATION
12 East 49th Street
New York, NY 10017
(212) 826-0808

Amicus Curiae

LAWRENCE T. PERERA
Counsel of Record
STEPHEN W. KIDDER
CHARLES FAYERWEATHER
HEMENWAY & BARNES
60 State Street
Boston, Mass. 02109
(617) 227-7940

Counsel for Amicus Curiae

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D. C. 20001

BEST AVAILABLE COPY

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	i
INTEREST OF *AMICUS CURIAE*	1
SUMMARY OF ARGUMENT	2
ARGUMENT	2
CONCLUSION	8

TABLE OF AUTHORITIES

CASES: Page

National Labor Relations Board v. Gullett Gin Co., 340 US 361 (1951) 3
National Labor Relations Board v. Rutter-Rex Mfg. Co., 396 U.S. 258 (1969) 2
National Labor Relations Board v. International Measurement and Control Co., 978 F2d 334 (7th Cir. 1992) 3
Phelps Dodge Corp. v. National Labor Relations Board, 313 U.S. 177 (1941) 4
Social Security Board v. Nierotko, 327 U.S. 358 (1946) 8
United Brotherhood of Carpenters and Joiners v. National Labor Relations Board, 365 U.S. 651 (1961) 2
United Steelworkers of America v. American Mfg. Co., 363 U.S. 564 (1960) 3
United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960) 3
United Steelworkers of America v. Enterprise Wheel & Car Corp., 363 U.S. 593 (1960) 3
Winn-Dixie Stores v. National Labor Relations Board, 413 F.2d 1008 (5th Cir. 1969) 3

STATUTES:

Age Discrimination in Employment Act, 29 U.S.C. § 626(c) 3
Americans with Disabilities Act, 42 U.S.C. § 12117(a) 3
Civil Rights Act of 1964, 42 U.S.C. § 2000e-5(g) 3
Equal Pay Act, 29 U.S.C. § 216(b), (c) 3

TABLE OF AUTHORITIES CONTINUED

STATUTES: Page

Federal Insurance Contributions Act, 26 U.S.C. § 3101, *et seq.* (Chapter 21 of the Internal Revenue Code) ..... *passim*
§ 3101 4
§ 3111 4
§ 3121(a) 4
Internal Revenue Code (see Federal Insurance Contributions Act) ..... *passim*
Jury Systems Improvement Act of 1978, 28 U.S.C. 1875(b)(1) 3
National Labor Relations Act, 29 U.S.C. § 160(c) 2
Social Security Act, 42 U.S.C. § 430 4
Uniformed Services Employment and Reemployment Act of 1994, 38 U.S.C. § 4323(c)(a)(A)(ii) 3

MISCELLANEOUS:

Bureau of Labor Statistics News Release, January 19, 2000 1
F. Elkouri and E. Elkouri, *How Arbitration Works*, 579-581 (5th ed., 1997) 3
Social Security Administration Program Policy Statement, SSR 83-7 (1983) 7
Social Security Administration, *Tax Rate Table and Maximum Taxable Earnings* (last modified Oct. 18, 2000), <http://www.ssa.gov/OACT/COLA/taxRates.html> 6

INTEREST OF AMICUS CURIAE

The Major League Baseball Players Association respectfully submits this brief *amicus curiae* for the purpose of bringing to the Court's attention the implications for employees of the matter before the Court.[1] The written consent of the Respondent and the Petitioner to the filing of this brief has been filed with the Clerk of the Court. This brief supports the position of the Respondent.

The Major League Baseball Players Association (the "MLBPA") is a labor union representing players employed by the Major League Baseball Clubs. The MLBPA is an unincorporated association with its principal offices located in the City of New York. MLBPA members were the recipients of the awards of back wages that are at issue in the matter before the Court.

There are approximately eighteen million American workers represented in their workplaces by organized labor unions. Bureau of Labor Statistics News Release, January 19, 2000. Each of these workers is potentially subject to contractual or statutory labor violations which may result in the worker earning less than he or she should during any given period of time. The usual remedy for a worker whose wages are so reduced is an award of back pay to make the worker financially whole. The interpretation of the Internal Revenue Code proposed by Petitioner can have the effect of reducing the value of a back pay award so that it does not make a worker financially whole. All employees have a substantial interest in combating this potential inequity.

---

[1] *Amicus curiae* and counsel for *amicus curiae* authored this brief in its entirety. No person or entity, other than the *amicus curiae* and its counsel, made a monetary contribution to the preparation or submission of this brief.

SUMMARY OF ARGUMENT

The purpose of a back pay award on account of a contractual or statutory labor violation is to make the affected worker financially whole. Under Petitioner's interpretation of the Internal Revenue Code, because of changing employment circumstances of an affected worker and because of changing Federal Insurance Contributions Act tax rates and wage bases, back pay earned in one year but paid in a later year may be subject to greater taxes than would have been imposed had the worker been paid when he or she should have been paid. Therefore, the back pay award does not actually result in the worker being made financially whole. This additional burden is most likely to fall on workers who have lower incomes in the year in which back pay is actually paid than they had in the year the back pay should have been paid. These workers are likely to be workers who are unemployed or underemployed and are least able to bear this additional tax burden. Workers who bear this additional tax burden receive no increased entitlement to Social Security benefits.

ARGUMENT

When union-represented workers lose wages because of a contractual or statutory labor violation by an employer or an industry as a whole, workers typically seek redress either through the National Labor Relations Board (the "NLRB") or through private arbitration.

When the NLRB determines that an unfair labor practice has occurred, its governing statutory authority, the National Labor Relations Act, 29 U.S.C. § 151 *et. seq.* (the "NLRA"), requires that it issue orders that return the affected workers to the same financial status they would have enjoyed but for the violation; no more and no less. 29 U.S.C. § 160(c); *National Labor Relations Board v. Rutter-Rex Mfg. Co.*, 396 U.S. 258, 263, 265 (1969); *United Brotherhood of Carpenters and*

Joiners v. National Labor Relations Board, 365 U.S. 651, 657, 658 (1961). When an unfair labor practice results in reduced pay, the NLRB is empowered to order back pay to the worker in order to make the worker financially whole.[2] *National Labor Relations Board v. Gullett Gin Co.*, 340 US 361, 363 (1951).

Similarly, under federal labor policy favoring peaceful resolution to labor management disputes, the parties to a collective bargaining agreement typically empower arbitrators to resolve disputes arising under the agreement. *United Steelworkers of America v. American Mfg. Co.*, 363 U.S. 564 (1960); *United Steelworkers of America v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 U.S. 593 (1960). When fashioning remedies for contractual violations, arbitrators routinely award monetary damages to place the aggrieved party in the same position in which he or she would have been absent the violation. F. Elkouri and E. Elkouri, *How Arbitration Works*, 579-581 (5th ed., 1997).

To ensure that a back pay award makes the affected worker whole, an award is made with interest from the date of the violation. *National Labor Relations Board v. International Measurement and Control Co.*, 978 F2d 334, 336 (7th Cir. 1992); *Winn-Dixie Stores v. National Labor Relations Board*, 413 F.2d 1008, 1010 (5th Cir. 1969); Elkouri and Elkouri,

---

[2] Back pay may also be awarded by other federal or state agencies or by federal or state courts under common law tort or contract principles or under a number of different statutes, including: Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e-5(g); Equal Pay Act, 29 U.S.C. § 216(b), (c); Age Discrimination in Employment Act, 29 U.S.C. § 626(c); Americans with Disabilities Act, 42 U.S.C. § 12117(a); Jury Systems Improvement Act of 1978, 28 U.S.C. 1875(b)(1); Uniformed Services Employment and Reemployment Act of 1994, 38 U.S.C. § 4323(c)(a)(A)(ii); analogous state statutes; and state and federal minimum wage acts.

supra at 591, n. 353. To ensure that a back pay award does not put the worker in a better than whole position, each back pay award is reduced by the amount of income that the affected worker was able to generate because of the unfair labor practice (*i.e.*, by finding substitute employment). *Phelps Dodge Corp. v. National Labor Relations Board*, 313 U.S. 177, 197-198 (1941).

The Congressional intent to make workers injured by contractual breaches financially whole, would be defeated in many back pay cases by the interpretation of the Internal Revenue Code proposed by Petitioner. Petitioner argues that the taxes collected from workers under Chapter 21 of the Internal Revenue Code, known as the Federal Insurance Contributions Act, 26 U.S.C. § 3101, *et seq.* ("FICA"), must be collected on any award of back pay based on the rules and circumstances that apply to that worker in the year of payment, not the year in which the wages should have been paid. Because FICA tax rates, wage bases and the wage income of any individual worker vary from year to year, the actual FICA taxes paid on a back pay award are likely to be different if FICA taxes are calculated based on the circumstances existing in the year the back pay is paid, rather than in the year it should have been paid.[3]

For example, between 1986, when some of the back pay in the current case should have been paid, and 1994 when it was actually paid, the rate for determining the employee portion of the OASDI component of the FICA tax rose from 5.7% to

[3] FICA tax is collected from both employer and employee and consists of two components: the tax for Old-Age, Survivors and Disability Insurance ("OASDI") and the tax for Hospital Insurance ("HI"). 26 U.S.C. §§ 3101 and 3111. Each component of the FICA tax is charged against no more than a maximum amount of a worker's wages; an amount known as the "contribution and benefits base" which is established each year under the Social Security Act, 42 U.S.C. § 430. 26 U.S.C. § 3121(a). The maximum contribution base is more commonly known as the "wage base."

6.2%. As a result, absent unusual circumstances, any worker who received back pay in 1994, for wages that should have been paid in 1986 would pay an additional 0.5% in FICA taxes under Petitioner's interpretation, and, to that extent, would not be made financially whole by the back pay award. In addition, the wage base for the HI component of the FICA tax rose from $42,000 in 1986 to an uncapped amount in 1994, with the result that back pay amounts in excess of $42,000 would be subject to an additional 1.45% in FICA taxes on such amounts in 1994, further widening the gap between the award and the goal of making the worker financially whole.

The situation would be particularly harsh for a worker who had actually been paid wages in 1986 at or above the maximum wage base subject to FICA taxes and who then received back pay in a later year when the worker's income was otherwise under the maximum wage base. For example, if a worker was actually paid $45,000 in 1986, when the wage base was $42,000, he or she paid the maximum amount of FICA taxes of $3,003. If he or she had received an additional $2,000 of wages in 1986, there would have been no additional FICA taxes. However, if in 1994 the worker received $2,000 of back pay with respect to 1986, and the worker's other wages in 1994 were $58,000 or less, the entire amount of the back pay award would be subject to FICA taxes under Petitioner's interpretation, because the wage base in 1994 was $60,600. In that situation the worker would pay additional FICA taxes of $153 with the result that the worker would actually receive only 92% of the amount that would have made the worker financially whole.

Applying the Petitioner's interpretation to the Major League Baseball players who actually received the back pay awards in the matter before the Court, will not make the players financially whole. The players who received a back pay award for 1986 were playing for a Major League

Baseball club in 1986 and, therefore, received wages in excess of the 1986 wage base. J.A. 9 (DCt Docket No. 27, Sum. J. Appendix, Exh. 10 (January 30, 1998)). As a result, the 1994 back pay award for wages that should have been paid in 1986 would, if actually paid in 1986, have been subject to no FICA taxes. However, treated as wages paid in 1994, as required by Petitioner's interpretation, the award would be subject to at least an additional 1.45% of FICA taxes (the 1.45% of uncapped HI) for any portion of the award over the player's wage base for 1994 and up to an additional 7.65% of FICA taxes (the full FICA tax rate in 1994) for any portion of the award under the player's wage base for 1994. As a result, it is clear that the back pay awards will not make the players financially whole.

FICA tax rates have tended to increase over time and the wage base subject to taxation changes every year because it is adjusted for average wage inflation.[4] If Petitioner's

[4] *Fifteen Years of Changes to FICA Tax Rates and Wage Bases*

Source: Social Security Administration, *Tax Rate Table and Maximum Taxable Earnings* (last modified Oct. 18, 2000), <http://www.ssa.gov/OACT/COLA/taxRates.html>.

Year	OASDI Wage Base	OASDI Tax Rate	HI Wage Base	HI Tax Rate
1986	$42,000	5.70%	$42,000	1.45%
1987	$43,800	5.70%	$43,800	1.45%
1988	$45,000	6.06%	$45,000	1.45%
1989	$48,000	6.06%	$48,000	1.45%
1990	$51,300	6.20%	$50,400	1.45%
1991	$53,400	6.20%	$125,000	1.45%
1992	$55,500	6.20%	$130,200	1.45%
1993	$57,600	6.20%	$135,000	1.45%
1994	$60,600	6.20%	No Limit	1.45%
1995	$61,200	6.20%	No Limit	1.45%
1996	$62,700	6.20%	No Limit	1.45%
1997	$65,400	6.20%	No Limit	1.45%
1998	$68,400	6.20%	No Limit	1.45%
1999	$72,600	6.20%	No Limit	1.45%
2000	$76,200	6.20%	No Limit	1.45%

interpretation of the Internal Revenue Code is followed, many back pay payments will be subject either to higher FICA tax rates or will be subject to FICA taxes that would not otherwise have been owed because the wage base in the year the back pay was earned had already been exceeded.[5] The workers most likely to be affected by this extra taxation are those workers who by the time of the back pay award are unemployed or underemployed and, therefore, earning less than the wage base amount, although they were making that amount in the year the back pay should have been paid. Workers affected will be the unemployed, the disabled and the retired. Not only does Petitioner's interpretation tend to defeat the purpose of back pay, which is to make the worker financially whole, but it tends to impose an extra burden on those workers who can least afford it.

The worker who bears the burden of extra taxation that could be imposed by Petitioner's interpretation of the Internal Revenue Code with respect to awards of back pay receives no compensating benefit in the form of greater entitlement to Social Security benefits. Unlike actual wages paid in a given year, back pay awards pursuant to a statute, such as awards by the NLRB under authority of the NLRA, are credited by the Social Security Administration to the year in which those wages should have been paid, not the year in which actually

[5] In the unlikely event that there was average wage deflation, resulting in a decrease of the FICA wage base, or there was legislation decreasing the FICA tax rate, between the time back pay wages were earned and the time they were paid, or if the worker had other wages in excess of the tax base in the year of the back pay award but not when the award should have been paid, under Petitioner's interpretation, the worker could receive a windfall. He or she could be paid an amount that would have been subject to FICA taxes had it properly been paid, but that would be subject to reduced or no FICA taxes when actually paid. The result would be to make the worker more than financially whole. Although clearly a benefit to workers, this result would also defeat the purpose of back pay awards, which is to compensate rather than reward, and would be equally wrong.

paid. Social Security Administration Program Policy Statement, SSR 83-7 (1983), relying on *Social Security Board v. Nierotko*, 327 U.S. 358 (1946).

CONCLUSION

Imposing FICA taxes on awards of back pay in the manner proposed by Petitioner defeats the purpose of back pay awards which is to make workers affected by unfair labor practices financially whole. In many circumstances, Petitioner's interpretation would result in workers paying additional FICA taxes without any increased entitlement to Social Security benefits. To the extent that additional FICA taxes are paid, workers are not made financially whole.

Respectfully Submitted

DONALD M. FEHR
Executive Director
and General Counsel
MAJOR LEAGUE BASEBALL
PLAYERS ASSOCIATION
12 East 49th Street
New York, NY 10017
(212) 826-0808

Amicus Curiae

LAWRENCE T. PERERA
Counsel of Record
STEPHEN W. KIDDER
CHARLES FAYERWEATHER
HEMENWAY & BARNES
60 State Street
Boston, Mass. 02109
(617) 227-7940

Counsel for Amicus Curiae

January 16, 2001